

CASE STUDY: THE STRATEGIC POSITION OF A MEXICAN BANK

by

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April 24, 2000

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Arnoldo C. Hax

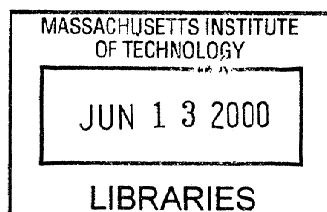
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ABSTRACT

The Mexican banking industry has experienced dramatic changes in the past 20 years. Its regime has changed from private to nationalized and back to private. As a result, changes in ownership have affected profoundly the industry. Also, drastic changes in the economic conditions of Mexico that have modified the shape of the industry have occurred; after one of the most severe economic crisis in its modern history, the country is quickly recovering and the outlook is promising. Finally, the globalization and consolidation processes are very important phenomenon affecting significantly the world economy and the banking industry in particular.

In this environment, the strategic position of Banco Nacional de México S. A., the largest Mexican bank has to be analyzed and reviewed in order to assess the strategic measures to be taken to successfully compete and survive in the industry, and at the same time, maintain its leadership position

Thesis Supervisor: Arnoldo C. Hax
Title: Alfred P. Sloan Professor of Management

Wellesley, Massachusetts, April 24, 2000

Dedication

To my family, my source of joy, encouragement, inspiration and support. Thanks for always being there, especially this year

María del Rocío Olivia (Oli), my wife

Marisol (Piqui) and María Paula (Monina), my daughters

Isidro Alfredo (Bebi) and Eugenio José (Yuki), my sons

Coty, my mother

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Isidro Martínez+, my father, I hope you are proudly watching us

José Abel+, Lolita+, Agustín+ and Rosa+, my grandparents, I hope you are proudly watching us too

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Lupita Olmedo, my mother in law, for trusting me her daughter

Juanita Lucas, our nanny, for helping our family and coming here with us this year

All my family and friends, who have always been willing to lend a hand in though times

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CHAPTER 1

Introduction

Goals of this Thesis

The Mexican Banking System was nationalized in 1982 by President Lopez Portillo, in an effort to stop “uncontrolled foreign currency outflows” out of the economy, as part of the measures taken by the Government to face the economic crisis that affected the country at that time. Since its re-privatization process in 1991-1992 during the administration of President Salinas, the Mexican Banking System has experienced tremendous changes that significantly affected the industry; these changes resulted first, in a big boom, and later in a bigger crisis.

The deregulation of the banking industry, the reduction of the inflation, the release of funds to the Banks that were previously destined to fund the Government, the increasing competition from foreign banks that brought disintermediation, the industry trend towards consolidation and globalization and the big economic crisis of 1995 have profoundly affected the market, imposing new conditions and forcing the Mexican banks to rethink their strategy and positioning.

Banco Nacional de México S.A. (Banamex) is the leading Mexican bank. Established in 1884, it has a long history and has played a very important role in the development of the Mexican economy.

Banamex, was acquired from the Mexican Government by its current stockholders in September 1991, and has successfully been able to take the leading role in the Mexican banking industry, against its main competitor Banco de Comercio, S.A. (Bancomer). However, the competition is continuing, and in the near future, will be even more fierce, due to the interaction of the newest entrants to the industry, such as the foreign banks and in particular the Spanish Banks (Banco Santander and Banco Bilbao y Vizcaya), and international Banks (Citibank, Bank of Nova Scotia and Hong Kong and Shanghai Banking Corporation).

Banamex follows the Universal Banking model; it is the main subsidiary of the Banacci Financial Group, Mexico's largest, which comprises besides Banamex, a Brokerage House (Acciones y Valores de México or Accival), an Insurance Company (Banamex- Aegon) and a Pension Fund (Afore Banamex-Aegon), in which Banacci holds 51% in partnership with the Aegon Group from the Netherlands, and through Banamex, a telecommunications company (Avantel) in which Banacci holds 51% in partnership with MCI Communications. The Mexican financial industry in general is changing toward a model in which, through the commercial banks, financial groups and parent companies are cross-selling

banking and non-banking products and services, leveraging on their client base and client knowledge, and on knowledge of the Mexican financial market.

This thesis will focus in evaluating Banamex's strategic position in light of the restructuring of the Mexican financial market and the consolidation and globalization trends taking place in the international arena. I will also try to determine possible strategic measures to strengthen and maintain Banamex's position in such a competitive market.

Methodology

This work primarily uses Professor Arnaldo Hax's strategy framework and tools, in particular his concepts from the book "The Strategy Concept and Process", and his work in "Adaptive Management".

The main sources from information are public sources, complemented with data obtained in some off- the- record interviews with officials from the Banacci Group.

CHAPTER 2

The Global Banking Industry

The Global Banking Industry

During the past two decades, from the Savings and Loans institutions failure in the United States to the mega mergers around the world, the Global Banking Industry has experienced major transformations. Along with those transformations, the world has converged in the formation of three major trading and economic regions, basically the European Union (EU), the North America Free Trade Agreement (NAFTA), and the Asian block, that has set the stage for the internationalization of the banking industry.

Technology Developments

During the 1980's and 1990's, very significant technological developments occurred. These developments not only made practically not existent the geographical barriers that prevailed in the financial markets around the world, but technology also brought with it the conditions necessary for financial instruments to be easily traded internationally, not only by the bigger banks and corporations, but by individuals too.

Electronic banking first and later Internet banking have been important factors that have changed the way in which the participants of the industry are competing. Banks have established first electronic banking divisions, and more recently e-banking divisions or even banks within their own corporate structure, such as Citigroup's Citi f/I (for financial interactive)¹, or Banc- One's Wingspan Bank.

The ability of the Internet to increase the quantity and quality of information available to customers, remove time and distance constraints and reduce information dissemination costs is a factor that is likely to impact the decision making of the consumer of financial services. The Internet has had unprecedented growth, and now, close to 100 million individuals are using the Internet². A very important factor for Internet banking will be the ability of banks to develop web sites with effective navigation conditions and excellent levels of confidentiality and security, that can help develop the confidence and trust of the users.

Starting in the early 1980's, the major Banks started working in electronic banking projects, such as a videotex service which was developed by Chemical Bank in 1981, "to bring to people with television sets or personal computers, through telephone, words and pictures – information about the stock market, airline schedules, the state of the world, the availability of tickets to shows,

¹ Morgan Stanley Dean Witter, Global Banking and Financial Services: Semiannual Update, November 1999

² Urban Glen et al, Design and Evaluation of a Trust Based Advisor on the Internet, December 1999

restaurant menus, the history of Bosnia- and banking services”³, and Citibank’s Home Base project for home computers, offering information and payment services. Both projects flopped but signaled a trend for the industry that was followed by many. Today the electronic banking activity is widespread around the world.

Such developments have also triggered a trend for the globalization and consolidation of the banking industry. With the advent of banking through the internet (e-banking), a number of the previously existent barriers to entry to the industry have disappeared, making it very easy for new competitors to try to enter the market, with relatively little investment requirements. Today, all that is really required to enter financial services is a phone line, a URL and a great idea. The emergence of the Internet has made the value proposition (pricing, service) more transparent to the investor, heightening price competition and commoditization of financial services.

Globalization

Banks, enabled by technology and deregulation, have been looking for expansion of their business, going outside of their traditional geographical boundaries to achieve a strategic positioning as a global bank.

³ Martin Mayer: The Bankers, the Next Generation, p168, 1997

Traditionally, the larger banks operated as international banks, mainly by establishing small subsidiaries or representative offices to pursue particularly the lending business, cash management and foreign trade business; in more recent years, the scope of their business has been expanding to private banking and other financial services, such as the personal insurance business. In some other cases, the larger banks have been looking for additional international business more aggressively by establishing banking subsidiaries in different countries. With the advent of the new telecommunications possibilities, the industry deregulation and the low telecommunications costs prevailing, globalization has been ever more possible.

The emerging countries, such as Latin American and Asian countries, have also been changing the rules and regulation that were previously in place, making these attractive and accessible for the expansion of international financial institutions. The high intermediation margins prevailing in these countries are also a point of attraction for international banks. The big banks of the world have also established footholds in the former soviet bloc, targeting not only the governments there, but also the nascent private sector.

The globalization trend however, has put a lot of pressure in the institutions competing in this industry. Such pressure has been manifest in an increasingly fierce competition for customers, and narrowing intermediation spreads, that force cost cutting policies and product innovation, and diminishing the importance

of previous business relationships. Following Professor Hax's Delta Model, a "Best Product" competition approach (low cost and product differentiation beat competitors by improving product economics⁴).

Also, Globalization has brought new risks, which the banks that participate in the globalization process, are not necessarily well prepared to manage, and business practices are different than the ones that such banks usually handle.

Consolidation

Another very important phenomenon that has been affecting the banking industry in the past 10 years is the consolidation process. Increasing competition in the financial services sector has generated a race to consolidate the industry and achieve a greater scale as a necessary prerequisite for improving efficiency⁵.

Banks are looking to improve their market share under an implicit assumption that a greater market share equals greater profitability. This assumption has not always been true, since there are examples of medium- sized as well as of large banks that are highly profitable.

Some banks have thought that the best way to increase size in a relatively quick way is to merge with other banks, or to take- over competitors. In the banking

⁴ Hax Arnoldo C and Wilde II Dean L., The Delta Model: Discovering New Sources of Profitability (pg. 5)

⁵ Canals Jordi, Universal Banking: International Comparisons and Theoretical Perspectives, Oxford University Press, 1997

industry, mergers are very complex processes, from both the strategic and cultural points of view.

According to Jordi Canals, bank mergers are not good or bad in abstract terms; they are good or bad on the basis of at least two criteria:

- The natural compatibility of the merging organizations and
- The clarity in planning the merger process and the effectiveness of the merger implementation process⁶

Mergers in the banking industry also occur to obtain cost reductions via the achievement of economies of scale and consolidation of the bank's resources, such as branches or information systems. Other mergers have occurred seeking to access a line of business (such as corporate banking), that a particular bank is lacking, or to strengthen a bank's financial position or business line.

Nonetheless, most mergers occur to achieve size or growth. In an increasingly global economy, banks linked up in numerous mergers of equals designed to create banking superpowers sizeable enough to compete and afford growing technology costs⁷.

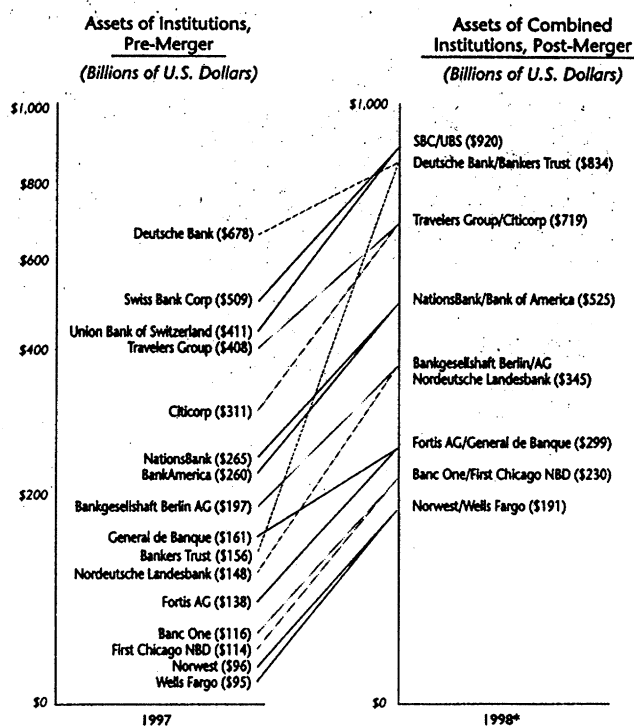
Industry sources, such as the *American Banker*, *Wall Street Journal*, *Financial Times* and even *McKinsey Quarterly*, believe that mergers announced around

⁶ Canals Jordi, *Universal Banking: International Comparisons and Theoretical Perspectives*, Oxford University Press, 1997

⁷ JP Morgan, *Bank Credit Outlook for 1999*, January 1999

the globe, mark the beginning of a sudden violent contraction that will leave the developed world with, depending on whom you believe, 5 or 12 banks. This is illustrated in the following graph (figure 1) showing the biggest bank mergers in 1997- 1998⁸. According to this view, the old merger analogy of the large fish swallowing the small is apparently being replaced with a new analogy: giants joined in wedded bliss racing to produce the first trillion-dollar offspring⁹.

Manifest Destiny



* Merger announcements 12/1/97-12/31/98.

Source: American Banker, 29 July 1998;
American Banker, 1 February 1999.

Figure1.

⁸ Corporate Executive Board, No End in Sight: Avoiding the "End Game" Trap in Financial Services, December 1998

⁹ The recent announcement (March 7,2000) of Deutsche Bank and Dresdner Bank merger, will create the world's largest bank, with US 1.2 trillion in assets, **the first trillion dollar offspring**

To further illustrate the consolidation trend, and some of the different reasons why mergers or buy-outs are happening, following is a table (figure 2) of the major strategic developments that took place in 1999. This table¹⁰ shows the main impact on the Competitive Edge of the banks acquiring or merging with other banks, as well as their main line of business. As we can see, mergers are occurring in every category of the industry, rather than concentrating in a specific line, such as commercial banking or asset management.

Banking and Financial Services –Major Strategic Developments, 1999 Year-to-Date

Acquiror	Target	Transaction Value (\$ Millions)	Impact on Competitive Edge*	Category-Global Competition
Bank of Scotland	National Westminster Bank	34,052	++	Consumer/Wholesale
Fleet Financial Group	BankBoston	15,925	4	Wholesale/Consumer/Asst Mgmt
BNP	Paribas	13,035	4	Wholesale
Banco de Santander	Banco Central Hispanoamericano	11,321	3	Local Markets
Lloyds TSB	Scottish Widows Fund & Life	11,120	++	Local Markets
Firststar Corp	Mercantile Bancorp	10,641	3	Local Markets
Banca Intesa	Banca Commerciale Italiana	10,128	3	Local Markets
HSBC Holdings	Republic New York Corp	7,703	3	Lcl Mkts/Prvt Bkng/Asst Mgmt
GE Capital	Japan Leasing Corp	6,566	3	Local Markets/Consumer
AmSouth Bancorp	First American	6,328	2	Local Markets
Zions Bancorp	First Security	5,678	2	Local Markets
Toronto Dominion Bank	CT Financial Services	5,303	2	Local Markets/Consumer
Banco Comercial Portugues	Banco Pinto & Sotto Mayor	3,887	++	Local Markets
CIT Group	Newcourt Credit Group	2,690	3	Wholesale
HSBC Holdings	Safra Republic Holdings	2,591	3	Consumer/Private Banking
E*Trade Group	TeleBanc Financial Corp	1,941	2	Consumer
Chase Manhattan	Hambrecht & Quist	1,350	3	Wholesale
First Union	EVEREN Capital Corp	1,172	2	Wholesale
Bank of New York	RBS Trust Bank	655	3	Operating Services
Credit Suisse Asset Management	Warburg Pincus Asset Management	650	3	Asset Management
Goldman Sachs	Hull Group	531	3	Wholesale

5 = Significant impact on competitive position/landscape; 0 = No impact; The announced combination of Dai-ichi Kangyo Bank, Fuji Bank, Industrial Bank of Japan and the merger of Sumitomo Bank and Sakura Bank were not included in this table due to the absence of disclosure on the transaction value.

++ Ratings and estimates for this company have been removed from consideration in this report because under applicable law and/or Morgan Stanley Dean Wilier policy, the firm may have been removed from consideration and/or precluded from issuing such information with respect to this company at this time.

Figure 2.

¹⁰ Morgan Stanley Dean Witter, Global Banking and Financial Services: Semiannual Update, November 1999

One- stop shop

A desired result of many of the bank mergers that have taken place in recent years is that, through these mergers, a wide range of financial services and products can be offered to customers, creating what is called one- stop shopping; bank customers will no longer need to depend on different financial firms.

In real life, companies and, to a lesser extent, individuals usually work with several banks at the same time. This is an indication that the concept of one- stop shopping does not exactly match business reality. However, when a universal bank has a company or individual as a customer, it has a greater chance of satisfying a greater number of his or her financial needs¹¹.

On the other hand, specialized banks usually have an image of experience or excellence for certain financial operations; they attract customers interested in their services, based on their excellent reputation.

The recent change in the U. S. banking laws has made it possible for banks and investment houses to join forces and offer a wide range of financial products to their customers. However, cross- industry mergers and one- stop shopping that once dominated scenarios for the evolution of financial services, are not

¹¹ Canals Jordi, *Universal Banking: International Comparison and Theoretical Perspectives*. Oxford University Press, 1997

necessarily going to mark the trend of the industry, because it is no longer clear that diversified financial conglomerates will benefit either customers or shareholders. As the Internet empowers users to create their own bundles of products and services, the removal of legal barriers to owning a broad range of providers look much less relevant to competitive strategy than it did in the past.¹²

The most common version of the consolidation myth used to be convergence. That theory held that discreet disciplines, such as banking, insurance, brokerage, etc., would converge into one- stop shops. These in turn would converge on a single portal that would be offered probably by Microsoft. What is happening in the real world, however, is the opposite. Despite a few mergers to build financial mega-malls, the majority of financial services have not actually converged. Laser- focused specialists are disaggregating financial services into tiny subset niches.¹³

Summary

The banking industry has experienced tremendous changes in the past few years. Deregulation, technology changes and a new political order have set the stage for a big wave of banking globalization and industry consolidation.

¹² Morgan Stanley Dean Witter, Banking and Financial Services: Semiannual Update, November 1999

¹³ Corporate Executive Board, No End in Sight: Avoiding the "End Game" Trap in Financial Services, December 1998

Large banks, in search of economies of scale and scope have merged with, or acquired other large banks. Cross- industry mergers have occurred, and in-market and cross- border transaction are also happening.

Barriers to entry in some segments have completely disappeared and increasingly, we are looking at new entrants in specialized financial services using Internet capabilities or in another fashion, establishing very small community banks aiming at customers desire for face- to- face intimacy.

Further mergers are anticipated to a point where the world will only have very few large global banks, a number of regional and super- regional banks, and a big and diverse array of community banks. In this environment, competition has increased dramatically and consumers have access to a great deal of information in order to make the right pick as to who will be their financial services providers.

CHAPTER 3

The Mexican Banking Industry

Introduction

This chapter is about the current state of the Mexican Banking Industry, with some references to its recent developments, since the history of this industry is beyond the scope of this thesis.

The Mexican banking industry has experienced dramatic changes in the past twenty years. The Mexican Government and the overall economic conditions of the country have been the determinant factors in the industry.

Pre- nationalization years

Prior to the Mexican financial crisis of 1982, a good business environment of continued growth characterized the industry, and most of the banks operating then were in sound financial conditions; the number of banks then operating in 1982 was over 60. Although there had been an economic crisis in 1976, that had led to the *peso* devaluation in that year, after being pegged to the dollar for 22

years since 1954, the country had managed to stabilize its balance of payments by 1978, and new oil discoveries helped improve rapidly the overall economic situation.¹⁴

There was increased presence of foreign banks, because of the Mexican oil boom, however except for Citibank, the foreign banks conducted no local branch business. A reassessment of Mexican creditworthiness in the international financial markets occurred; Mexico seemed well - placed to use its natural resources to finance development. Foreign banks were all too ready to supply loans to the Mexican government in the belief that governments, especially those with vast oil reserves, did not default. Foreign banks also lent big amounts of money to selected Mexican corporations.¹⁵

In this environment of good economic conditions, the Mexican banks were able to conduct promising business, capturing a good portion of the Mexican deposits and channeling those funds – mostly *pesos*- to the Mexican corporations and the mortgage loan markets; some of the banks held large amounts of stock of Mexican corporations. Banks ownership was highly concentrated.

However, mounting Mexican government deficits and the softening of the oil prices in early 1982, made it increasingly difficult for the country to continue financing its ambitious development plans with new loans from abroad.

¹⁴ Helen Shapiro, with amendments by Huw Pill: Mexico (A), From Stabilized Development to Debt Crisis, Harvard Business School case 9-797-096, August 1997

¹⁵ Ibid.

Nationalization years

After vowing to “defend the *Peso* like a dog”, President Lopez Portillo was forced to devalue in February 1982. Speculation against the peso continued in the following months, and capital was leaving the country -some days at a rate of 400 million dollars per day-, the Mexican government had to devalue again the *peso* in early August 1982. On August 12, 1982, a moratorium was announced on the so called Mexdollar accounts, which were dollar- denominated deposits held in Mexican banks; these Mexdollar accounts were to be redeemed in *pesos* at an unfavorable exchange rate.

In September 1, 1982, President Lopez Portillo -accusing Mexican bank owners of taking the country’s foreign reserves out of Mexico-, nationalized the banking system, in a vain attempt to stem the flood of capital fleeing Mexico; only Banjercito (a bank belonging to the Mexican army), and the banking subsidiary of Citibank in Mexico, were left out of this unprecedented measure. Exchange controls were also inaugurated.

Mexican bank shareholders were indemnified with Bonos de Indemnizacion Bancaria (Bank Indemnization Bonds), issued by the Federal Government and the stock of the companies that belonged to the banks were transferred back to the bank’s previous shareholders, or sold back to the private sector.

The principal positions of the nationalized banking system were largely put in the hands of politicians, but some of the larger banks were able to retain key officials in its management. The Mexican government started reducing the number of banks, mainly through a number of mergers, finally consolidating the industry to 18 banks.

After the Mexican banks nationalization, President de la Madrid's administration eased financial regulations to permit certain banking activities to be undertaken by mixed enterprises with significant private participation, and private brokerage houses were granted wide latitude to finance transactions in domestic capital markets.¹⁶

From 1982 to 1990, the Mexican banks' business consisted mainly of capturing *peso* deposits and funding the Government's deficit, having only on average around 10% availability of the deposits for other business; consumer credit was practically reduced to zero (only credit cards were available), and mortgage lending was only available for low income housing through government subsidized programs. The only available loans in dollars were foreign trade related and subject to strict exchange controls.

After the stock market crash of 1987, at the height of that year's crisis, corporations could only get funds through *extra-bursatil* operations, (deposits

¹⁶ Helen Shapiro, with amendments by Huw Pill: Mexico (B) Escaping from the Debt Crisis, Harvard Business School case 9-797-105, August 1997

channeled to the corporations through banks, in bank off- balance operations): long term lending in those days meant 7 days. The international banking presence in the 1982- 1990 period, was mostly reduced to restructuring of prior to 1982 government and corporate debts, and very selective new lending.

The change in the Mexican banking sector started in 1988, as the country was preparing for the President Salinas administration to take office. The Mexican banking industry was deregulated from 1988 when interest rate controls were largely eliminated. Restrictions on the convertibility of pesos into foreign exchange were progressively relaxed and eventually eradicated.

Private Again

In 1989, the requirements for the Mexican banks to finance the government and to lend to politically favored sectors were abolished. In April of that same year, the interest rate ceilings on bank deposits was eliminated, and commercial banks were able to set their own rates, according to market conditions of loanable funds. Reserve requirements, - an implicit tax on financial intermediation- were reduced significantly. This process culminated in a thirteen-month period from June 1991, to July 1992 during which eighteen banks were privatized in a series of auctions.¹⁷

¹⁷ Huw Pill: México (C): Reform and Crisis 1987- 1995, Harvard Business School case 9-797-050, July, 1998

President Salinas privatized the Mexican banking industry at a high selling price, which reflected the good perspectives of the country. In the new banking industry, diversified ownership was encouraged by limiting individuals to hold no more than 5% equity stakes; institutions were limited to 10%. Foreign capital was permitted, but restricted to a minority condition (although NAFTA would allow subsidiaries of American and Canadian banks to enter, on a phased basis, after 1994). Yet Mexican banks were encouraged to coagulate into large financial conglomerates, incorporating brokerage houses and insurance companies, in an attempt to exploit economies of scale and scope associated with financial services¹⁸.

At the same time that the privatization process was concluded, the economic reforms took effect in Mexico; confidence in the country was surging and, an economic revitalization took place. Consumption rose in anticipation of future higher incomes; in this favorable environment, the Mexican banks were free again to lend. After a decade of no credit, the Mexican corporations and individuals were credit starved; this created a boom in the banking industry and increased competition for new customers. As Mexico's economic reforms progressed, foreign banks increased its presence, taking minority positions in Mexican Banks, opening new Representation Offices and increasing lending. The number of "emerging market" funds ballooned in the early 1990's.

¹⁸ Huw Pill: México (C): Reform and Crisis 1987- 1995, Harvard Business School case 9-797-050, July, 1998

As a result of the economic boom of the early 1990's and the huge capital inflows then coming into the country, the previously dormant Mexican banking sector became suddenly an international market leader. In 1992, out of the 1,000 largest banks in the world, three of the twenty- five most profitable were Mexican; in 1993, the corresponding figure was seven.¹⁹ This condition, however, was misleading, since it masked underlying weaknesses.

As previously mentioned, during the nationalization years, the banking sector's role in Mexico, was mainly to channel deposits to the government; the institutional infrastructure had weakened, and expertise in risk assessment and credit controls significantly diminished in most of the banks. The new owners of the banks, most of whom were drawn from the ranks of stock brokers and dealers (a very different business in terms of risk assessment); these owners had a risk- taking market approach, that was ill- suited for the more conservative business of retail banking.

In the early 1990's, the newly privatized Mexican banking industry suffered from a lack of preparation to cope with the enormous volume of lending that was then flowing. For example there was no credit bureau to check the individual borrower's credit record; it was possible to extend one's credit limit to its maximum and then obtain a new credit line from another bank to service the existing debt. The poor institutional infrastructure of the banking sector was mirrored by the authorities' supervisory and regulatory bodies. A deposit

¹⁹ From the annual survey of international banks conducted by *The Banker* (1994,1995)

insurance scheme was in place but it didn't take into account the banks' underlying credit portfolio riskiness, and all deposits were insured regardless of their size or the holder of the account.²⁰

In the early 1990's, the previously restricted number of branch offices grew significantly, banks were able to establish branches and expand their presence in new regional markets increasing competition. However, this branch growth contrasted with a fall in national savings in the period; individuals denied access to new and foreign goods because of previous crisis, were buying them, increasing their spending.

From 1992, bad loans began to mount in the banking system. Mexican accounting standards prevailing at the time were different from international standards, permitting the banks to "hide" this problem. Then crisis struck the country again in early 1995 and things radically changed again.

Crisis years

After the 1995 crisis, the banking industry has struggled to survive, with many banks being taken over by the Government through its Agency, Instituto Nacional de Proteccion al Ahorro Bancario, and with Government-Banks sponsored programs to restructure debts of corporations and individuals as well. Foreign

²⁰ Huw Pill: México (C): Reform and Crisis 1987- 1995, Harvard Business School case 9-797-050, July, 1998

banks have again diminished lending, but were not very badly hurt, since their lending is mostly directed to the corporate segment.

The Mexican crisis was of a tremendous magnitude in the country's society, and the banking sector was very severely affected. Not performing loans reached unprecedented levels, and the public mood was very negative towards the banks; a moral hazard problem arose, with some people that could keep paying their debts not honoring them, and blaming the government and the banks of all their problems. To try to alleviate this problems, as previously mentioned, the government in conjunction with the banks, put together "financial rescue" programs, mostly aimed at small and medium sized corporations, and at the mortgage loans segment; a new account unit UDIS (Unidades de Inversion) based on inflation was introduced, so people and corporations could restructure and continue to serve their debts.

The aforementioned problems put a lot of strain in some of the banks, leading to their bankruptcy and to their take over by the now defunct Fondo Nacional de Proteccion al Ahorro Bancario (FOBAPROA), the country's banking deposits protection fund. Some of the distressed banks that had been taken over by FOBAPROA, were subsequently sold to foreign banks. Among these, the most relevant cases are the purchase of Banco Mexicano by Banco Santander-Hispano (BSCH), the purchase of Banco Probursa by Banco Bilbao Vizcaya-Argentaria (BBVA), and the purchase of Banca Confia by Citibank.

Consolidation

This also reflects the trend of consolidation that exists around the world. Exhibit 1 shows how bank consolidation has accelerated in Mexico, over the past five years.²¹

Consolidation in the Mexican market is reflected in the Herfindhal- Hirschman (HH) Index, a measure that is commonly used by central bankers to assess banking sector consolidation and guide regulatory thinking,²² the HH Index in Mexico has increased in the 1994- 1999 period 17%, and further consolidation of the industry is expected.

Search for economies of scale and scope to compensate for the reality (or expectation) of falling interest rates, compressing net interest margins, low efficiency levels, and declining profitability is a condition to survive in the new banking industry, globally and locally; this drove the banking consolidation in Chile in 1996- 1997 and is going to drive further consolidation in the Mexican banking industry.

²¹ Goldman Sachs Investment Research, Latin American Fact Sheet, February 2000

²² The HH Index is nothing more than the sum of the square deposit market shares of the institutions that comprise a certain banking system. Theoretically speaking, the HH Index can range from a high of 10,000 (a monopolistic banking sector in which one bank has 100% of the market – $1 \cdot 10,000^2 = 10,000$) to a low of 0 (an infinitely fragmented banking sector in which an infinite number of banks have 0% of the market each – $\text{infinite} \cdot 0^2 = 0$)

Foreign Banks in Mexico

As previously mentioned, the presence of foreign banks in Mexico is not new. However, they are now taking a more active role, and are entering the more lucrative (though riskier) retail segment.

In the past, foreign banks limited its presence to the corporate banking segment; if the country was doing well and expectations were good, they would increase their presence, and in the opposite scenario, they would diminish their presence.

When the government privatized the banks, foreign ownership was restricted to minority holdings, however, this has change in recent years (mainly motivated by the financial crisis and the global banking trends), and now 100% foreign ownership is permitted.

Despite the recent financial crisis, the outlook for Mexico is positive, and the foreign banks have taken advantage of market conditions and regulations to buy distressed banks and establish increased presence in the industry. Old timers, such as Citibank, rely mainly on local management and now are entering the retail segment through its purchase of Confia. Newcomers, such as BSCH and BBVA are relying mostly in “imported management” (foreign national they send from their home offices, many of whom have solid banking careers built in other countries), and seem to be after a more general and universal strategy; they are

trying to build a network of banks in Latin America, to leverage their franchise and benefit from cross- fertilization of products, people and technology.

Local Banks

Local banks are now practically reduced to three main players, Banamex, Bancomer and Banco Mercantil del Norte (Banorte);²³ however, they have been able to maintain their strong presence in the market. In 1994, Banamex and Bancomer dominated the Mexican banking market, with a combined 40% deposit market share. Five years later, Banamex and Bancomer remain the two most dominant financial institutions in the country, with 40%- plus of the system's deposits.

Why is this so? What is behind this success in competing against the powerful foreign banks that arrived to their shores? The following list gives the answer to these questions:

- They have dominant size and market share
- They have strong brand name recognition
- They have extended and diversified distribution networks
- They have strong, stable, first- class local management teams
- They have superior knowledge of their own domestic markets, sectors and companies

²³ Although the recent (March 9, 2000) announcement of a proposed merger, between BBVA and Bancomer in Mexico will reduce this number to two.

- They were investing aggressively in systems, technology product development, brand awareness, and distribution infrastructure long before foreign banks arrived
- They were proactive, took the initiative and moved first

This condition however is not secure, and increased competition is taking place, as the country's economic outlook is improving. The recently announced BBVA-Bancomer merger, reflects the interest in the industry of the foreign banks remains; it also reflects a plan to dominate and conquer the Mexican market.

The future

The Mexican banking industry will continue to consolidate. Most of the distressed banks have already been taken over by the government or bought out by foreign competitors, so competition is likely to increase.

Most of the changes in regulation and supervision have already taken place, capital requirements have been raised to international standards, and the economic perspectives of the country are good; these are other factors for increased competition.

The Mexican banking industry will continue to look for ways to leverage brand, cross- sell new financial products and increase product offering. After five years

of almost no new credit, banks will cautiously but surely return to the lending market.

One very important aspect of the industry is the move to Internet banking. The main banks in Mexico and in Latin America have announced important transactions that represent the beginning of a secular change in the way the banking business is done in Latin America. In Mexico, Banamex has recently announced a joint venture in Business-to-Business (B2B) with CommerceOne, and BBVA's joint venture with Terra to provide Internet banking to BBVA's banking clients in Latin America (including Mexico) are only the first of what could be many Internet ventures not only by these banks but also by their competitors.²⁴

Mexico remains a credit starved and under banked country and the banking industry remains an attractive business proposal; growth in this industry is expected and with it, new competitors.

²⁴ Morgan Stanley Dean Witter, Latin American Banks, Who is winning the Internet Race... and for How Long, January 2000

CHAPTER 4

Structural Analysis of the Mexican Banking Industry: The Five Forces Model

In this chapter, I will use Michael Porter's²⁵ Five Forces Model to try to illustrate the structure of the Mexican Banking Industry. This analysis is made in the context of the Mexican banking industry, taking into consideration its relationship with the worldwide banking industry.

Porter postulates that there are five forces that typically shape an industry structure: intensity of rivalry among competitors, threat of new entrants, threat of substitutes, bargaining power of buyers, and bargaining power of suppliers. These five forces delimit prices, costs, and investment requirements, which are the basic factors that explain long-term profitability prospects and hence, industry attractiveness.²⁶

Following is a brief description of my overall assessment of the Mexican banking industry. When assessing the future state, I am referring to a 5-year time horizon.

²⁵ Michael E. Porter; *Competitive Strategy*, New York Free Press, 1980

²⁶ Arnaldo C. Hax, Nicolas H. Majluf, *The Strategy Concept and Process- A Pragmatic Approach*. Prentice Hall, 1996,1991

For the Five Forces Diagram, please see Appendix 2. For detailed reference diagrams, please go to Appendix 3.

	Current				
	Future				
Overall Industry Assessment					
Overall assessment		Low Attractiveness	Medium Attractiveness	High Attractiveness	

Figure 3. Overall Industry Assessment

In the overall industry assessment, the industry is considered of Medium Attractiveness, slightly improving in the future; given the favorable credit reviews that Mexico as a country has recently obtained²⁷, and the optimistic outlook of the economy, it could even be turn to be very attractive.

Currently, the industry is overcoming of a lot of problems and the control of many banks is changing hands. However, with the aid of the Government rescue packages, together with an improving economy, many banks are now profitable and building up reserves, in order to prepare for future growth. In the future, the banking business is likely to improve given the favorable perspectives of the

²⁷ On March 7, 2000, Moody's Investor Services (Moody's) announced it was upgrading Mexico's long-term foreign debt obligations to investment grade, from Ba1 to Baa3. Standard and Poors followed on March 13, 2000 with an upgrade of Mexico's long-term foreign debt rating from BB to BB+, but not yet investment grade rating

economy, the need for credit, the improved regulatory framework and supervision and the potential for growth of the industry, since Mexico is still considered an under banked country and the huge credit needs of the Mexican society at large.

The Attractiveness of each factor is as follows:

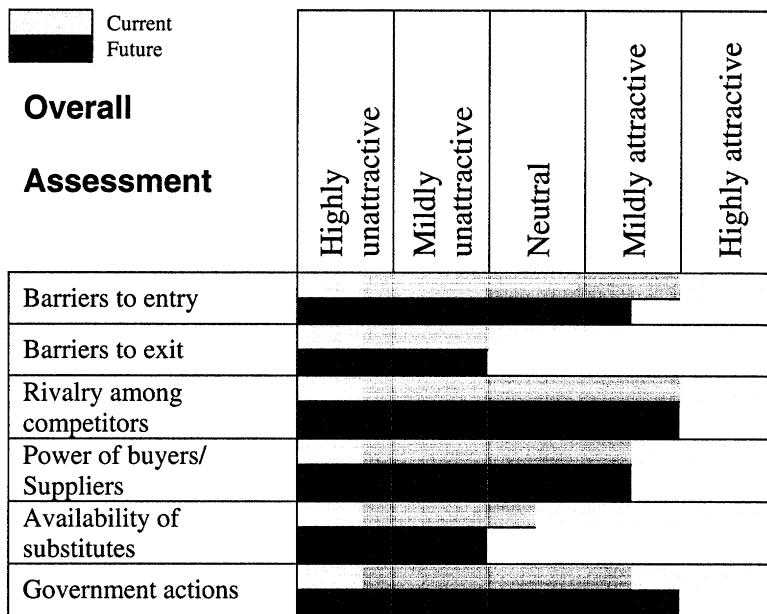


Figure 4. Overall Factor Assessment

Comments to Barriers to Entry: This industry requires large capital amounts and economies of scale in order to be a dominant player. Strong brand identification and moderately high switching cost for companies is the rule. Experience effect is very important in the industry. The Government protection is likely to improve, in terms of regulations, however this will also have the effect of having clearer rules and therefore, less risk.

Comments to Barriers to Exit: Although financial assets are relatively easy to sell at the right price, the banks' physical assets could be highly specialized and the cost of exit could be quite high. Emotional barriers or Government and social restrictions are not considered a big barrier to exit at this time.

Comments to Rivalry Among Competitors: The number of banks with equal forces is very reduced. Banamex and Bancomer²⁸ (the second largest bank) together, amount to close to half of total market share, with the rest of the banks trying to gain market share or in some cases merge. There is no current or anticipated large capacity increases and the diversity of competitors is low. However, in the future, increased competition is anticipated, coming mainly from foreign banks already operating in Mexico and to a lesser extent, from new entrants.

Comments to Power of Buyers: The number of individual buyers is large, and companies are increasingly in need of more sophisticated banking services. Although at first sight there is many available substitutes, and the switching costs appear to be low, these is not entirely true, because of the long term relationships prevailing in the market, and the limited competition in banking technologies. There is almost no threat of buyers' backward integration.

²⁸ Pre- merger with BBVA

Comments to Power of Suppliers: There is no single large supplier in the industry, and the market is plentiful of suppliers (money, technology, goods, etc). The only constraint is constituted by long-term dollar denominated funding availability and price.²⁹ There is not supplier's threat of forward integration, nor is it anticipated in the future.

Comments to Availability of Substitutes: The possibility of substituting banking services with another bank's services or a non- bank provider is quite high; however, in the aftermath of the Mexican crisis, no new significant entrants have arrived, nor are they expected to increase in the future. However, if the Mexican economy continues to improve, there will be again a lot of competition and this aspect of the industry will become unattractive. The main source of competition would then be foreign banks; in this respect, industry consolidation could be expected.

Comments to Government Actions: The rescue package has been very big, but no more rescue packages are anticipated. Regulatory and supervisory measures have been taken to assure better banking practices; there is now availability and widespread use of credit information (credit bureau). There are no special tax components for this industry, however, there are minimum capital amounts and

²⁹ Although this is likely to change due to the recent upgrading of Mexico's long- term debt rating

reserves required (Basel Committee Rules).³⁰ Foreign ownership although small at the time, is no longer restricted and is likely to increase in the future.

Implications for Banamex

For Banamex, it is very important to be prepared for the future. Banamex has been fixing its post- crisis problems at a very rapid pace. They finished their capitalization process in 1999 and now the banks reserves cover over 100% of the loan portfolio; this is a very important step to resume the lending activity. Banamex has also taken important steps to grow in the future by increasing its branches by almost 40% in the post- crisis years and by expanding its sale force.

Banamex has not been alone in this fixing process, but has been able to make these changes rapidly and without diluting the shareholders. In order to get the capital required to overcome the crisis problems, Banacci was able to leverage its client base and bring in partners in the other businesses of the group and use those resources to strengthen the bank's capital base. Banamex also seem to have made the necessary changes required to comply with the more strict banking regulations and supervision.

³⁰ The Basel Committee Supervisory Rules require banks to comply with a standard target ratio of capital to weighted risk assets of 8% (of which the core capital element should be at least 4%). The Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards (July 1988, updated to April 1997)

As the industry attractiveness increases, the competition for Banamex will become stronger, and its leading position in the Mexican banking industry will be challenged. Banamex will face attacks from international competitors in segments of the business that in the past had remained almost exclusive for Mexican banks.

Although the banking business requires large amounts of capital, for the international banks, the capital necessary to enter the Mexican market is not an issue. However, the Mexican banks, and in particular Banamex, will rely on its strong brand and on the risk considerations to defend their positions in the market; foreign banks could overcome these conditions by taking- over local banks with strong brand identification and local risk- management know- how.

No additional major exits of participants are anticipated in the Mexican banking industry. The government has taken- over all distressed banks and is selling them mostly to foreign investors. However, increased merger activity is likely to come, as the proposed Bancomer- BBVA merger, and Banamex, is likely to be involved in this activity, either by acquiring some of the smaller banks, or by being acquired or merged into a larger foreign bank.

Thus, if merger activity picks- up, as it is likely to happen, rivalry between competitors will become stronger. If merger activity is smaller than anticipated,

the big banks, such as Banamex, will continue to dominate the Mexican banking industry.

The power of buyers could potentially improve with increased competition. However, hidden switching costs and technological issues could make diminish this potential. Banamex can leverage its long standing relationships and its technology advantages to retain customers, but it is likely that its customers are no longer going to have one single source of banking services.

The power of suppliers is not considered an issue with regards to the Mexican banking industry. There is plenty of availability of funds for Banamex, and the recent upgrading of Mexico's sovereign debt, brought also as a consequence, the upgrading of Banamex to investment grade also; this will increase Banamex's foreign currency funding and pricing alternatives. However, there is still volatility in the country and Banamex, and the rest of the banks in the industry will have to look for ways to secure appropriate funding sources.

Availability of substitutes is likely to increase with the entrant of new non-banking competitors. Banamex will have to make use of its non- banking arms (leasing and factoring divisions) to compete with them; it could also consider re-establishing them as separate entities to face the increased competition. The changes on this subject will have to be closely followed by Banamex and the rest of the Mexican banks.

The government is playing a key role in the definition of the Mexican banking industry. If the government decides to open completely the industry to foreigners and not to foster and strengthen the development of Mexican banks, it will face increased political pressure. On the other hand, improved regulation and supervision by the government is likely to benefit the industry and its main players such as Banamex.

The challenges for Banamex are not so far in the horizon, and Banamex has been preparing to face them. Whether or not this preparation is enough is a matter of how hard the attack will be.

CHAPTER 5

The Strategic Position of Banamex

Banamex has been able to develop and maintain a strong corporate culture and franchise through its 115 years of existence. Nevertheless, the period of nationalization and the subsequent privatization that followed in 1991, the effects of the 1995 economic crisis, and the industry consolidation process, makes an analysis of the strategic position of the Banamex desirable and interesting at this time.

This analysis will try to determine the strategic position of Banamex, to try to understand on the one hand, the environment in which it perform its business and the factors affecting it, and on the other hand the internal characteristics of the organization.

I will use Professor Hax's³¹ strategy framework as a guideline to try to determine Banamex's strategic position.

³¹ As outlined in Chapter 9 of *The Strategy Concept and Process*, Arnoldo C. Hax and Nicolas S. Majluf, 2nd edition, Prentice Hall, 1996

Environmental Scan at the Corporate Level

This first step in trying to assess Banamex's strategic position, deals with understanding the external forces that are having an impact in Banamex. Three elements guide the environmental scan:

- economic overview
- primary industrial sectors
- basic external factors

Economic Overview

First, it is important to define the geographical regions in which Banamex operates. Currently, Banamex conducts business in approximately 394 communities in all regions of México, through an extensive network of close to 1,300 branches and offices.

Figure 5 shows the existing and potential new geographical scope of Banamex:

Banamex: Existing Geographical Scope	
- Domestic	
+ Mexico, divided in 7 major regions:	Metropolitan Northern Northwestern Central Western Southern Gulf States
- International (through subsidiaries)	
+ United States of America (California Commerce Bank)	
+ Argentina (Bansud)	
Banamex: Potential New Geographical Scope³²	
+ Southern portion of the United States of America (directly)	

Figure 5. Geographical Scope

Given Banamex's international and technological capabilities, its telecommunications network and the strong Mexican cultural presence in the southern portion of the United States of America (USA), I believe that in the near future it will try to increase its direct presence, a move that already has been announced by Bancomer.

The critical economic factors³³ that affect Banamex's main business activity are shown on Figure 6.

³² This represents the Author's own assessment and does not reflect any official information or statement from Banamex

³³ Source: Banco de México and Instituto Nacional de Geografía e Historia for historic figures; for future figures, consensus estimates drawn from selected economic forecasts from J P Morgan, Warburg Dillon Read, Deutsche Bank Research, Dresdner Kleinworth, Banamex and Bancomer among others

	A C T U A L			E S T I M A T E D	
Mexico	1997	1998	1999	2000	2001
GDP Growth %	6.8	4.8	4.8	4.8	4.3
Inflation Rate % (Dec/Dec)	15.7	18.6	12.3	10.5	8.8
Unemployment Rate %	3.7	3.2	2.5	2.5	2.5
Annualized 28- day Cetes Rate (Jan) %	19.8	24.76	21.4	15.7	12.2
Peso Rate Ps/ \$ (avg.)	7.919	9.136	9.6	9.7	9.73
Population Growth %	1.82	1.82	1.82	1.82	1.82

Figure 6. Analysis of Economic Factors

Given Banamex's economic activity, the main macroeconomic indicators of Mexico are key to understand the economic factors affecting Banamex. The chart above shows how Mexico's economy has been recovering and that the outlook is positive. Inflation is expected to continue to decline in the next two years, interest rate is expected to decline also, and GDP is expected to grow at a reasonably healthy rate.

These factors on the one hand will help the banking activity remain sound, because the lower rates and increased economic activity will help solve the past due loans problem, yet, on the other hand with lower inflation and interest rates, intermediation spreads are reduced.

Primary Industrial Sectors

The analysis of primary sectors related to Banamex's activity is important because it deals with the state of the industries related to the business of the firm. Figure 7 shows a description of the principal sectors identified.

		A C T U A L		Current	E S T I M A T E D	
		1997	1998	1999	2000	2001
Avg. % change on previous calendar year	Private Consumption	6.4	6.4	3.4	4.7	4.6
	Gross Fixed Investment	21	10.7	5.8	9.1	9.5
	Manufacturing Production	9.8	7.4	4.1	5.3	5.5
	Average Industrial Wages	19.7	19.7	17.4	13.7	12.4
Annual Total	Public Sector Budget (GDP %)	-0.7	-1.2	-1.2	-1.1	-1.1
	Merchandise Exports (US\$ bn.)	110.4	117.5	136.7	153.9	171.5
	Merchandise Imports (US\$ bn.)	109.8	125.4	142.1	162.5	183.3

Figure 7. Primary Industrial Sectors

Because of its national coverage and its universal banking approach, Banamex is related to almost every industrial sector of the economy. Therefore, the aggregated economic activity³⁴ related to industrial sector investment, private consumption, manufacturing production and wages in the domestic side, and the trade activity in the external side resumes the activity affecting Banamex.

³⁴ Source: Banco de México for historic figures; for future figures, consensus estimates drawn from selected economic forecasts from J P Morgan, Warburg Dillon Read, Deutsche Bank Research, Dresdner Kleinworth, Banamex and Bancomer among others

Reflecting the improving state of the Mexican economy, and its trend towards stability, these factors imply increased activity in the banking sector.

Basic External Factors

This element describes the external factors favorably and unfavorably affecting Banamex, regarding technological trends, supply of human resources, political factors, social factors and legal factors. Figure 8 describes the scenarios concerning these factors.

Basic Factors	Pessimistic	Most Likely	Optimistic
Technological Trends	<ul style="list-style-type: none"> - Competing banks, with better and proprietary telecom and systems technology capture a big share of the market - Failure to enter the internet banking market 	<ul style="list-style-type: none"> - Similar technology will be available for all participants - Entrance to internet banking market is successfully achieved 	<ul style="list-style-type: none"> - Development of superior and proprietary telecom and systems technology - Failure of competitors to enter the internet market
Supply of Human Resources	<ul style="list-style-type: none"> - Decrease of loyalty towards the bank due to recent restructuring and low salaries. - Difficulty to hire young, sharp people in a booming employment market, due to deterioration in the corporate image after the 1995 economic crisis 	<ul style="list-style-type: none"> - Loyalty towards the bank remain - Hiring of good young professionals at the branch level remains a concern in a booming employment market 	<ul style="list-style-type: none"> - Employee loyalty and pride, increase due to improved performance of the organization - The corporate image improves and attraction of good people is achieved. The industry becomes attractive again
Political Factors	<ul style="list-style-type: none"> - Mexican government favors foreign competitors to attract capital to the industry - Failure of the government to pass banking reforms and improved regulations 	<ul style="list-style-type: none"> - Equal rules and treatment for all competitors - Government passes reforms and regulations to the banking industry, after lengthy House debates 	<ul style="list-style-type: none"> - Government favors development of strong local banks - The speed of approval of reforms and regulatory changes is increased
Social Factors	<ul style="list-style-type: none"> - Moral hazard problem (no payment) remains in some sector of the population - Some sectors of the population attracted to foreign banks 	<ul style="list-style-type: none"> - Moral hazard problem slowly disappearing, people concerned about bad credit history - People slowly being attracted by foreign competitors 	<ul style="list-style-type: none"> - Credit activity picks up, people concerned about credit history, start repaying past due loans - People reluctant to change to a foreign competitor
Legal Factors	<ul style="list-style-type: none"> - Law enforcement remains in bad state - House rejects reforms in the law enforcement system 	<ul style="list-style-type: none"> - Law enforcement improving - House passes additional reforms 	<ul style="list-style-type: none"> - Law enforcement improves substantially - House passes reforms in speedy manner

Figure 8. Alternative Planning Scenarios

Technology will be a critical factor for Banamex to compete in the Mexican banking industry. Banamex has continuously been investing in technology, yet, the pace of technological could outgrow current investment. Also the development of some proprietary systems, such as cash management and payment systems is key to compete in the industry.

Another critical factor is the depth of Banamex's human capital. Traditionally, Banamex, has been a tremendous generator of talent in the banking industry and its personnel has been very loyal and proud however, other banks have taken advantage of this talent, and with the impact that the economic crisis had on salaries, and the stressing conditions that some of its personnel had to endure during the economic crisis years, loyalty could have diminished. Banamex has to be very careful to avoid a scenario in which its personnel loyalty diminishes and in which it cannot attract and develop new young and talented executives, because of lack of attractiveness of the corporate image or the industry.

Political, Social and Legal factors affecting the banking industry, have been changing rapidly in Mexico. However, more changes are needed to bring the industry to complete international conditions. The general political environment of Mexico in which there is a lot of friction between the parties, could slow down the reform process. Banamex will have to continue to join forces with the rest of the industry to make the changes take place. An area of specific concern is law enforcement; the banks will have to work together more effectively to pressure

the government to implement the changes necessary to ensure a just and adequate law enforcement process.

Key Opportunities and Threats

In this part of the environmental scan, I try to identify the key opportunities and threats that Banamex faces at this time. Figure 9 lists them.

Key Opportunities	
Economic Overview	<ul style="list-style-type: none"> - GDP is expected to grow above 4% in the next 3 years - Economic stability is anticipated with lower inflation rate - Free Trade Agreement with European Union will increase trade and financing needs - Lending activity is expected to resume due to favorable outlook
Primary Industrial Sectors	<ul style="list-style-type: none"> - Recovery in purchasing power and income of the population could bring increased needs of consumption financing - Investment and manufacturing production increases, demand bigger financing needs
Technological Trends	<ul style="list-style-type: none"> - Increased electronic banking trend for which Banamex is technologically well prepared - Banamex is taking a leading position in Mexico in internet banking, B2B³⁵ e-commerce, and has recently signed partnership with industry leader Commerce One to become franchisee for Latin America
Supply of Human Resources	<ul style="list-style-type: none"> - Banamex is recognized for having the most skilled employees in the Industry and has been so far able to keep attracting talent
Political Factors	<ul style="list-style-type: none"> - Reforms to regulations and supervision in the industry for which Banamex is much better prepared than most domestic competitors - Desire of the government to have at least one strong local competitor
Social Factors	<ul style="list-style-type: none"> - Banamex has been able to maintain a solid image through the crisis which is attracting new customers - Moral hazard problem slowly disappearing

Figure 9. Key Opportunities for Banamex

³⁵ B2B = Business to business electronic commerce

Key Threats	
Economic Overview	<ul style="list-style-type: none"> - Increased economic volatility due to elections in 2000 - Economic stability could decrease intermediation spreads - Country risk reduction could increasingly attract competition from abroad - Although not likely to happen, a new economic crisis could potentially wipe - out the Mexican banks
Primary Industrial Sectors	<ul style="list-style-type: none"> - Recovery in purchasing power and income of the population is attracting foreign banks to participate in this profitable segment - Increased participation of foreign banks or corporate leasing agents (such as GE Capital) to finance imports of machinery and inventories
Technological Trends	<ul style="list-style-type: none"> - Foreign banks with good electronic systems with international linkages and capabilities could capture a big portion of the corporate segment - Foreign competitors with already established international financial portals are increasingly attracting corporations and investors
Supply of Human Resources	<ul style="list-style-type: none"> - Increased risk of losing key personnel and not being able to replace talent loss or attract new talent due to industry labor market competition
Political Factors	<ul style="list-style-type: none"> - Increased political pressures towards banks rescue package - Election year could trigger an artificial economic boom, followed by an economic crisis
Social Factors	<ul style="list-style-type: none"> - Overall bad image of domestic banks during and after the economic crisis - Local corporations and general public attracted to foreign competitors

Figure 10. Key Threats for Banamex

Banamex appears to be well prepared to take advantage of the key opportunities arising from the economic, regulatory and market changes. Banamex, on the other hand will face very important challenges to its dominant market position due to the same considerations.

The Mission of Banamex

The mission of the firms represents what the firm is all about. It defines on the one hand the business scope, which is the areas in which the firm competes, and on the other hand defines the unique competencies of the firm, or how does the firm compete.

Banamex has not made publicly explicit its mission. This could be caused, either because it had not taken the required time to define it, or probably because of some strategic consideration unknown to the Author.

In this section, I will try to define the Mission of Banamex. To do it I will rely on the personal knowledge that I have acquired after some years of working there, and on some of the comments that arose from the informal interviews conducted as part of this thesis.

Figure 11 shows the Mission of Banamex.

Banamex. Mission Statement
Banamex is devoted to provide its customers with the best financial products and services in the markets it competes. The basis of this commitment is the core corporate values. Banamex wants to be recognized as the leading Mexican provider of financial services. To achieve this condition, Banamex relies on the best systems and personnel, in the Mexican industry and considers its human resources its most valuable asset.
Product Scope
<i>Now:</i> Traditional investment and financing banking products and services, mutual funds, trust services, estate planning services and products of its subsidiaries, such as life insurance, pension funds, and long distance services, through Banamex's traditional distribution channels (branches), and increasingly through electronic and internet means. <i>Future:</i> Preserve its leadership in financial products, increasing its presence in the retail market, through new and innovative financial products and complementary products. Introduce local telephone services, data and Handling services. Participate in B2B electronic commerce. Introduce sell of Health Management Services
Market Scope
<i>Now:</i> Provide financial products and services to the Mexican market through a network of 1300 branches, and representative offices in the United States and London, its ATM network, and through its internet financial portal <i>Future:</i> Preserve its emphasis in the distribution channel, increasing Banamex's presence in internet banking. Increase presence in the retail market and increase cross - selling of new products and services.
Geographical Scope
<i>Now:</i> Mexican market, southern California market. <i>Future:</i> Mexican market, southern United States market, Latin American market at large.
Unique Competencies
<i>Now:</i> Excellent franchise recognition, skilled and experienced personnel, strong balance sheet, product innovation, strong client relationships, strong strategic alliances, strong management team, good systems infrastructure, recognized leadership in internet capabilities and proven sales force and distribution channels. <i>Future:</i> Maintain strong franchise, client relationship, and current strong managerial and infrastructure capabilities. Continue attracting skilled personnel. Develop skills to compete in Latin America. Increase Internet presence. Increase cross - selling skills. Increase financial strength. Ability to integrate possible acquisitions.

Figure 11. Banamex Mission Statement

Business Segmentation

The proper segmentation of the businesses in which Banamex competes is a key activity in the strategic planning process. This task requires continuous redefinition and adjustments to keep the pace with the dynamics of the market and the environment, and to reflect the possible expansion of Banamex into other markets. Figure 12 shows the business (defined as SBU's or strategic business units) in which Banamex is to participate.

BUSINESS UNIT	RESPONSIBLE MANAGER	RATIONALE FOR SEGMENTATION
- Credit Cards	Deputy President, Commercial Banking/ Deputy President, Credit Cards & Products	- Specialized Business to be distributed through existing distribution channels
- Commercial and Retail Banking	Deputy President, Commercial Banking	- Main sales force and distribution channel
- Private Banking	Deputy President, Commercial Banking	- Specialized attention required, High Net worth Individuals
- Corporate Banking	Deputy President, Corporate Banking	- Special segment, highly skilled personnel is required
- Institutional Banking (Government Accounts)	Deputy President, Institutional Banking/ Deputy President, Commercial Banking	- Special Segment, High degree of Relationship Building required
- Real Estate Lending	Deputy President, Real State Lending/ Deputy President, Commercial Banking	- Specialized Business coming out of a big crisis
- Complementary Products (Cross-selling of subsidiaries' products)	Deputy President, Commercial Banking/ Deputy President, Corporate Banking	- Sales and distribution of complementary products from the bank's subsidiaries
- Internet Banking	Deputy President, Internet Products/ Deputy President, Commercial Banking	- Special new segment, specialized distribution channel
- B2B e-commerce portal	Deputy President, Internet Products	- New business, sales support from bank and bank credit products key to success

Figure 12. Banamex Business Segmentation

Horizontal Strategy

This section deals with trying to identify elements where potential synergism can be found in Banamex. Identification of the interrelationships across different business units is very important in the definition of the horizontal strategy.

There are two major kinds of interrelationships among business units, tangible and intangible. Tangible interrelationships arise from opportunities to share activities in the value chain. Intangible interrelationships involve the transference of management know-how among separate value chains.

The main tangible and intangible interrelationships among Banamex's business units are shown in Figures 13 & 14

Value- Chain	- Credit Cards	- Commercial and Retail Baking	- Private Banking	- Corporate Banking	- Institutional Banking (Govmt.. Accts)	- Real Estate Lending	- Complementary Products (Cross-selling of subsidiaries' products)	- Internet Banking	- B2B ecommerce portal
Activities									
Inbound Logistics	★	★	★	★	★	★	☆	☆	☆
Operations		★	★	★	☆	☆		✦	✦
Outbound Logistics	★	★	☆	★	★	☆	☆	✦	✦
Marketing & Sales	★ ☆	★	★	★	★	★ ☆	★ ☆	✦ ✦	☆ ✦
Service	★	★	☆	★	★	☆	☆	✦ ✦	✦
Procurement	★	★	★	★	★	★	☆	✦ ✦	✦
Technology Development	☆	★	☆	★	★	☆	☆	✦	✦
Human Resource Mgmt	★	★	☆	★	★	☆	☆	✦	✦
Firm Infrastructure	★	★	★	★	★	★	☆	✦	✦

- ★ Shared Activity
- ☆ Potential Sharing
- ✦ Shared Activity
- ✧ Potential Sharing

Figure 13. Tangible Interrelationships

Inbound and outbound logistics are activities where tangible interrelationships exist and have the potential to increase among the different businesses. Marketing and Sales is also an activity of synergy, where Banamex can leverage

its image by supporting the different businesses through corporate advertising. In general, there are important interrelationships among the different businesses.

Banamex is seeking to fully exploit them, by having a scheme of centralized functions, such as purchasing, marketing, and product units, and could increase its results by extending the scope of these functions, at least at the normative level to its subsidiaries.

Also, Banamex could also achieve better results by centralizing its operations (back- offices) for the different businesses and even by making those available at a profit, to its competitors.³⁶ Examples of centralization are the credit card approval process, the private banking back office, and the credit control offices management. At the regional level, consolidation of branch back office could be also achieved.

³⁶ On October 29, 1998 Banamex and Bancomer announced a 50/50 Joint venture to handle some of the peso and check payment operations back- office functions. This joint venture could eventually offer its services to competing banks).

Value- Chain Activities	- Credit Cards	- Commercial and Retail Banking	- Private Banking	- Corporate Banking	- Institutional Banking (Govt. Accts)	- Real Estate Lending	- Complementary Products (Cross-selling of subsidiaries' products)	- Internet Banking	- B2B e-commerce portal
Corporate Clients	★	★	☆	★			☆	☆	☆
Retail Clients	★	★	★			★	☆	☆	
Major Suppliers	★	★	☆	★	☆	☆	☆	☆ ✦	☆ ✦
Domestic Markets	★	★	★	★		☆	★	★	★ ☆
Foreign Markets	★	★					★	☆	★ ☆

- ★ Shared Activity
- ☆ Potential Sharing
- ✦ Shared Activity
- ✧ Potential Sharing

Figure 14. Intangible Relationships

There are also intangible interrelationships in terms of market segments and geographical scope. Banamex, can take full advantage of its account management approach to cross- sell all of its suitable products to a certain client, through its existing sales force, and extend the cross- selling activity to its

subsidiaries' products; this represents a very important source of value for Banamex, since economies of scale and scope can be achieved very rapidly.³⁷

Appendix 4 shows Banamex's value chain. Banamex's support activities are fundamentally well, but this condition is not true in all activities. Human resource management is an area of opportunity for them; compensation and reward systems appear in need of improvement, and an on-going training program is not clearly identifiable; also, overall structure alignment apparently has not been achieved, there seems to be some lack of coordination between the different activities. Technology Development is another area that appears to need improvement; basically market research and product design look misaligned and tailor made products and bundling have not yet been fully achieved.

Primary activities appear to be well overall, however, post-sale service and customer training need improvement. Increased use of ATM and electronic banking has been encouraged, and e-banking capabilities are available for all customers. However, complete realization of Banamex's physical infrastructure capabilities is yet to be accomplished.

³⁷ An example of this consideration is the rapid penetration of Banamex- Aegon, Banacci's insurance company, in the life insurance business. In less than two years, it has become one of the leaders in the field.

Vertical Integration

Vertical integration involves the decision of whether or not, a firm should acquire the necessary assets and allocate the necessary resources to perform a certain activity of the value chain. The need to acquire this capability is determined by strategic reasons, cost considerations, and administrative capabilities. Vertical integration could be backwards, or getting closer to suppliers, and forward, or getting closer to customers. The benefits of vertically integrating or outsourcing should be weighed against the costs in order to determine whether or not to vertically integrate or outsource an activity.

In the case of Banamex, there are certain activities of the value chain that could be the subject of integration. The first activity to be considered should be the data handling and electronic systems development integration. Historically, Banamex has tried to be self sufficient in this activity, due to strategic considerations, security reasons, and proprietorship rights to its systems, however, increased dynamics in the design and development of systems and the high investment amounts required to keep up in this activity, makes outsourcing economically attractive and strategically desirable for Banamex. I believe that they should keep inside only the most strategic portion of this activity and outsource the rest.

Another area of potential outsourcing for Banamex is the sales force required to manage the sales effort of new products. Banamex is currently leveraging its

sales force in order to achieve economies of scale and scope, for the sale of new products or products of its subsidiaries. However, increasing proportionately its sale force is not economically feasible; therefore, Banamex could potentially “vertically integrate” the sales force of its subsidiaries through a new sales force, of a wholly owned “service” subsidiary, that would provide the sales force to sell Banamex and its subsidiaries’ products. This service subsidiary would have a different wage and benefits scheme designed to allow Banamex to increase economically its sales force. Whether this strategy is successful depends on the skill of Banamex’s sales force management to fully realize the potential of this decision; also recruitment at the level of the service subsidiary is key to success. The best people in the service subsidiary’s sales force could be eventually used as a good source of recruitment to replace Banamex’s personnel when required.

There is other areas of potential outsourcing for Banamex, such as personnel services, some of its non- critical back office operations, and non- strategic product development, that should be carefully evaluated. At this point, vertical integration of other activities for Banamex should be limited only to strategic functions; among them, Internet design and development should be carefully considered.

Corporate Philosophy

The Corporate Philosophy is a statement usually made by the CEO or the CEO in collaboration with the top management, outlining the fundamental and permanent values of a corporation.

The Corporate Philosophy statement typically talks about the following issues:

- The relationship between the company and its stakeholders
- A statement of broad objectives of the company's expected performance
- A description of basic corporate policies concerning management style, organizational policies, and human resources management among others
- A statement of corporate values pertaining to ethics, beliefs, and rules of personal and corporate behavior

Figure 15 reflects the author's perception and proposal about Banamex's

Corporate Philosophy:

Existing		Desired
Relationships with Stakeholders		
Employees	The Bank's most important asset. Fair competition and rewards among individuals. Stress fair and professional management practices	Continue giving utmost relevance to personnel. Encourage importance of results and reward them. Develop and retain key employees
Customers	Understand and satisfy the clients' financial needs (products and services). Be a quality service provider. Be a source of financial innovation	Build and maintain long term relationships. Become the preferred financial advisor to our customers
Shareholders	Achieve sustainable and high R O E. Achieve stock price similar to pre- crisis value	Increase and sustain high R O E levels. Maintain leadership position in the Mexican financial markets. Achieve higher than market stock appreciation
Suppliers	Fair competition among suppliers. Build strong relationships leading to trust	Maintain strong relationships leading to the sharing of potential savings. Build a partner relation with suppliers
Communities	Increase relationship with the communities in which we participate	Become one of the leading financial drivers in the country to continue to improve the quality of life of our communities
Broad Corporate Objectives		
Growth	Increase in market share, and customer base	Continue expansion of customer base and market share Achieve additional growth through the introduction of new and complementary financial products
Profitability	Increase profits by reducing costs and increasing fee related income	Increase profits by further reducing costs, and increasing Intermediation and fee revenues
Corporate Policies		
Management Style	Foster team work and cooperation. Fairness and respect for all employees	Building of high- performance management and work teams
Organizational Policies	Decentralization of market related activities. Regional structure Centralization and tight control of support functions	Further decentralization of market related activities Retain central control of support activities and policies
Human Resource Mgmt.	Attract the best individuals. Identify and develop skills in the workforce. Strengthen career development opportunities for our employees	Attract and develop the most skilled workforce in the industry Offer an attractive compensation package based on results and achievements
Finance	Maintain the required capital levels without asking for additional equity capital from current shareholders	Build a capital base required for corporate and dividend growth Improve financial position to reduce cost of capital
Technology	Be the leader in banking technology and systems	Be the leader in banking technology, electronic data handling and Internet banking and applications
Corporate Values		
Beliefs and Rules of Personal Behavior	Respect. Excellence. Productivity. Compromise. Professionalism. National (Mexican) Identity Discretion. Flexibility. Respect. Honorability. Trust worthiness	

Figure 15. Banamex Corporate Philosophy

Summary

The overall environment in which Banamex conducts business has been dramatically changing in the past few years mainly due to the economic crisis and expertise and know-how factors, and the industry appears to be in a transitional state. However, the Environmental Scan shows that the overall economic conditions of the country are improving and some banks, through government backed programs and capital infusions have been preparing for better days.

The dynamics of the Mexican economy and the primary industry factors affecting the banking industry are favorable. These are important factors for Banamex, which has been working to strengthen its finances and solve the past due portfolio problem arising as a result of the Tequila Crisis, and now appears to be ready to take full advantage of the better economic conditions. With a much more solid balance sheet, Banamex will be able to provide funding for the economic development of the country and even venture into other promising markets or expand its product scope. Yet, Banamex will not be alone in the fight for the post-crisis market.

Technology and human resources management have become very important factors that will play a pivotal role for Banamex to be successful. The ability that Banamex to capture the enormous business potential arising of the rapidly

increasing use of the Internet is becoming fundamental for its future. Other external factors, such as the changes in the legal framework and supervision in the banking industry, as well as the political developments in Mexico, also play a key role for the business development of Banamex and the Mexican banking industry in general.

The ability of Banamex's management to deal with the opportunities and threats now prevailing in the external environment will be key to maintain its market leadership position.

The internal scrutiny of Banamex shows that in general, while they have been busy surviving, they have also been preparing to increase and defend their leadership position in the market. Business segmentation is clear and they have been searching for synergies and interrelationships among their different business units to take full advantage of their assets. This is key for the future survival of Banamex, since it will face a formidable competition. There are still a number of opportunities for improvement that Banamex must explore and revise in an on-going basis.

Banamex has increased its product scope, mainly through joint venturing with strategic partners, and in the process raising much needed capital from these partnerships. Banamex has been able to leverage its franchise and its sales force to add value to the firm. Clear examples of this are the sale of a minority

portion of its long distance company Avantel to MCI World Communications, and the sale of its Pension Fund and its Life Insurance subsidiary Seguros Banamex, to the Aegon group. Through these joint ventures, Banamex's partners have been able to acquire instant access to the market, by utilizing Banamex's sales force and business relations. These intangible interrelationships between different subsidiaries that share customers and markets, have been tried to be fully exploited by Banamex with good results, so far. Yet, Banamex's personnel has been subject to a lot of competitive pressure to sell a wider array of products, without having been necessarily well trained, and without been fully compensated for this effort.

Banamex is at the same time looking for ways to obtain cost reductions by exploiting its tangible interrelationships, such as maximizing its assets in the back office function internally between different of it strategic business units, and even by joint venturing with its main competitor, in order to obtain economies of scale.

The corporate philosophy of Banamex reflects a very solid heritage of more than 110 years of existence. However, the current shareholders have been trying to instill much more aggressiveness and hunger in the sales force, in order to compete in the changing environment. This change is yet to be totally achieved and as such, reflected in the corporate philosophy.

CHAPTER 6

Banamex and the Triangle

There are two most celebrated and influential frameworks for strategy:

- Michael Porter's Competitive Positioning³⁸
- Prahalad and Hamel's Resource Based View of the Firm³⁹

The Competitive Positioning Framework

The Competitive Positioning framework states that there are two basic determinants of the profitability of a business, the structure of the industry in which the business belongs, and the competitive positioning of the business within that industry.

Industry structure explains the value of the industry and how it is distributed among participants. Porter postulates that there are five forces that shape the structure of the industry: Intensity of rivalry among competitors, threat of new

³⁸ Michael E. Porter's work in Competitive Positioning, is in his books, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*, New York: The Free Press, 1980, and *Competitive Advantage*, New York, The Free Press, 1985

³⁹ C. K. Prahalad and Gary Hamel, *The Core Competence of the Corporation*, Harvard Business Review, May- June 1990, pg. 71- 91

entrants, power of buyers, power of suppliers, and threat of substitutes. Appendix 2 shows the five forces diagram for the Mexican banking industry.

The competitive positioning is the basis of a firm for establishing a sustainable competitive advantage against competitors. Porter's value chain is the tool for assessing the competitive positioning of a business. Appendix 4 contains Banamex's value chain. Porter states that there are nine broad tasks in which the business organization can be classified. Five are called *primary activities*, which are the ones involved in the physical movement of supplies and finished products, manufacturing activities, marketing and sales of the products and the servicing of the products of the business. The other four are the *support activities* and their essential role is to support the primary activities and each of the other support activities as well. These include the infrastructure of the firm, human resource management, technology development and procurement.

The forces shaping the structure of the industry are largely external and not controllable to the firm, but the activities in the value chain, are the controllable factors for the firm to achieve competitive superiority.

The winning formula in this framework is finding an attractive industry in which a firm can pick a business in which it can excel or achieve close to a monopolistic position (Strategy as War).

The Resource Based View of the Firm

The Resource Based View of the Firm postulates that the central forces of competitive advantage depend upon the development of the resources and capabilities by the firm. It states that competitive advantage is created when resources and capabilities that are owned exclusively by the firm, can generate unique core competencies. These unique advantages are retained by the firm and cannot be imitated or substituted by its competitors.

Unique competencies are drawn from resources and capabilities of the firm, which often, are the result of investment in durable, specialized and not tradeable factors that are not easily lost to competitors.

Sustainability means that the uniqueness of a competitive advantage should be preserved. The resources of a firm should be valuable, scarce and difficult to imitate or substitute.

Appropriability refers to the question of who will capture the rents of a specific market. Sometimes the owners of a business do not get the totality of the value created because non- owners might control specialized complementary factors that might divert the cash away from the business and into those complementary businesses (a hold- up)

The final condition necessary in this framework is that the cost incurred in acquiring the resources is lower than the value created by them

The winning formula postulated by this framework is to develop resources and capabilities that are unique, non- tradeable, valuable and turn them into unique competencies that could be sustainable and not imitated or substituted by competitors, to capture the economic rents in the firm's market and make sure that the investment cost does not offset the value generated (Strategy as real estate). The firm and not the industry becomes the source of profitability.

The Delta Model

The above-mentioned two strategies have been perceived as antagonists and opposing. A third framework is now being proposed by Professor Hax who does not consider the previous two alternatives as opposing, but rather as incomplete. This third framework, known as the Delta Model⁴⁰ states that both frameworks are incomplete and in that sense, complementary to each other. The Delta Model is an integrative process for formulating and executing strategy. The Delta Model intends to position a firm in one of three corners of *the triangle*: The Best Product zone, the Total Customer Solutions zone, and the Systems Lock-In zone.

⁴⁰ The Delta Model is being postulate by Professor Arnolndo C. Hax and Dean L. Wilde II, in the soon to be published book, *The Delta Model: Discovering New Sources of Profitability*

Depending on which strategy the firm is following and which characteristics describe the firm, it can be located in *the triangle*. *The triangle* is a tool to describe a meaningful strategic position. The three distinct alternatives in the triangle let the managers see the position that reflects the strategy of the business. The management then should decide if that position is desired or if the firm should try to move to another position.

Figure 16 shows the diagram of the Delta Model. As previously mentioned, the Delta Model defines three potential options as distinct sources of profitability for a business:

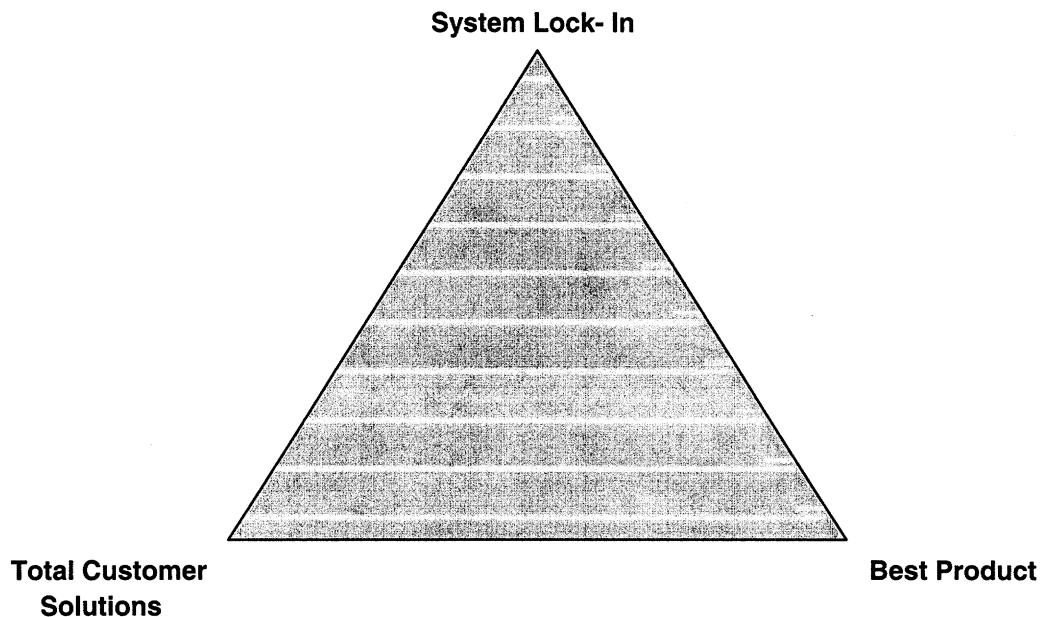


Figure 16. The Delta Model

The Triangle: Options for Strategic Planning

“Best Product”:

The companies in this category use low cost and product differentiation to beat competitors. Its relevant economic drivers are centered on the value chain of the product or service. Products and services tend to be standardized and unbundled for a faceless and generic customer that gets them through mass distribution channels. The customer's main driver to buy the product, are the intrinsic characteristics of the product. In this strategy there is practically no bonding with the customer and therefore, the firm is totally vulnerable to the attacks of new entrants.

“Total Customer Solutions”:

This is a complete reversal of the “Best Product” option. Bonding with the customers plays a key role in this strategy. Total customer solution companies, learn as much as they can about each customer so they can provide them with customized solutions, rather than looking at them as faceless entities. Rather than focusing on product economics, they concentrate in the customer's economics. They do not offer independent products, they offer a bundle of product and services aimed at solving a wide array of customer needs.

“System Lock- In”:

This option has the widest possible scope. Now the focus becomes not only the customer or the product, but all the meaningful players in the system that contribute to the creation of economic value. Bonding is the most important consideration in this option. The firm now focuses on nurturing, attracting and retaining “complementors”, which are providers of product and services that enhance our own offering. The critical issue is to look at the whole system to see how can the firm gain “complementor” share in order to get competitor lock- out and customer lock- in.

The three strategic positions are focused on three different economic perspectives. The way that the firms obtain their economic margins is totally different. In the Best Product strategy a firm capture its margin, either by having the lowest cost and therefore a low price, or by differentiating the product and in turn charge a higher margin. In the Total Customer Solutions option, the firm captures its margin by providing the customer with higher economic contributions through the firm's products and services; the firm could charge a customer more, provided that the benefits for the customer are higher than the cost incurred. Finally, in the System Lock- In strategy, by looking at the system as a whole, the firm is able to capture its margin by creating additional value to the system by attracting heavy investment by “complementors”.

The current position of Banamex in the "Triangle"

Prior to the privatization of Banamex, the bank was completely focused in the Best Product strategy. Every line of business had to be profitable on its own, and Banamex focused exclusively on having the best price, or the product or service with the best characteristics, or both. This was primarily the way the rest of the Mexican banking industry competed, although there were a couple of banks that tried to bundle some products, but this efforts were mainly to attract customers by reducing the price of the bundle, rather than to enhance customer profits. Figure 17 shows Banamex's strategy of those days by its position in the Triangle.

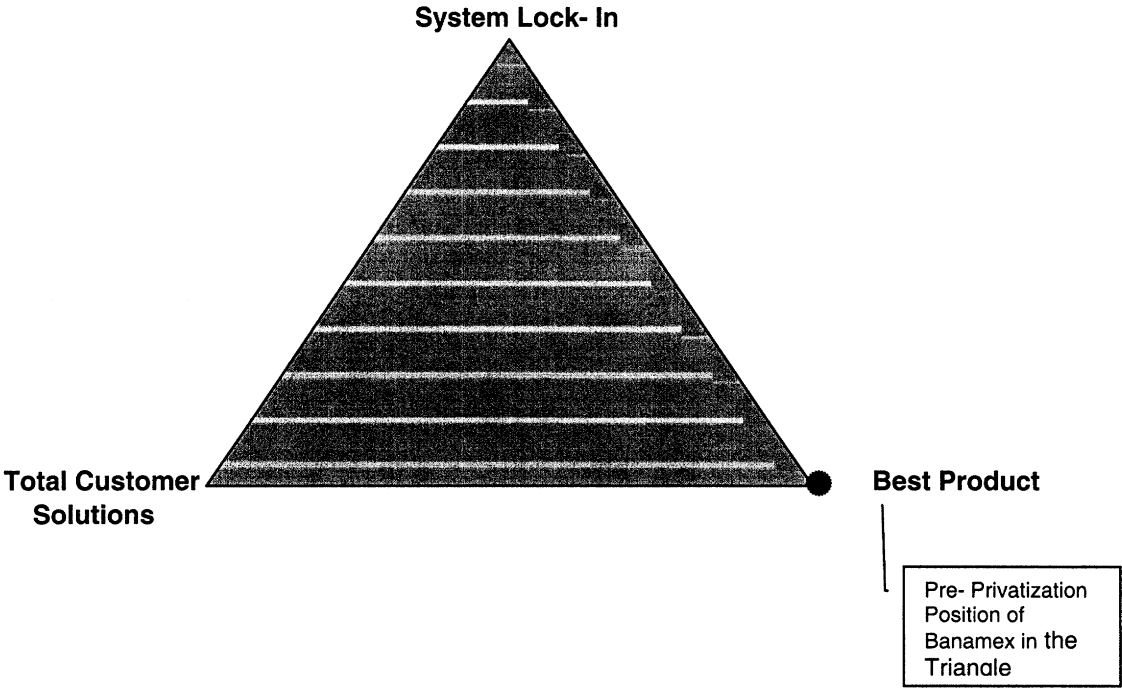


Figure 17.
Pre- Privatization Position of Banamex

Also, Banamex's organizational structure prevailing in those days was designed for a Best Product strategy. There were little interrelation between the different strategic business units and there was no formal incentive to combine efforts to sell "total solutions" to the customers, and although every account manager wanted his or her customer to buy as many products and services of the bank, he or she found resistance from the different areas to customize or specially price a product or a bundle for the customer.

It is also important to mention that the information technology strategy followed the organizational structure design and therefore, the systems were not flexible enough to "customize" a specific requirement of a customer. If a customer proposed a modification to a system, the answer to the petition would be no, unless a big enough number of customers had the same need.

After the privatization of Banamex, the bank's new shareholders and management have been trying to have a more flexible offering of products and services for its customers, however, these efforts have not been completely successful. Figure 18 shows the current position of Banamex in the triangle.

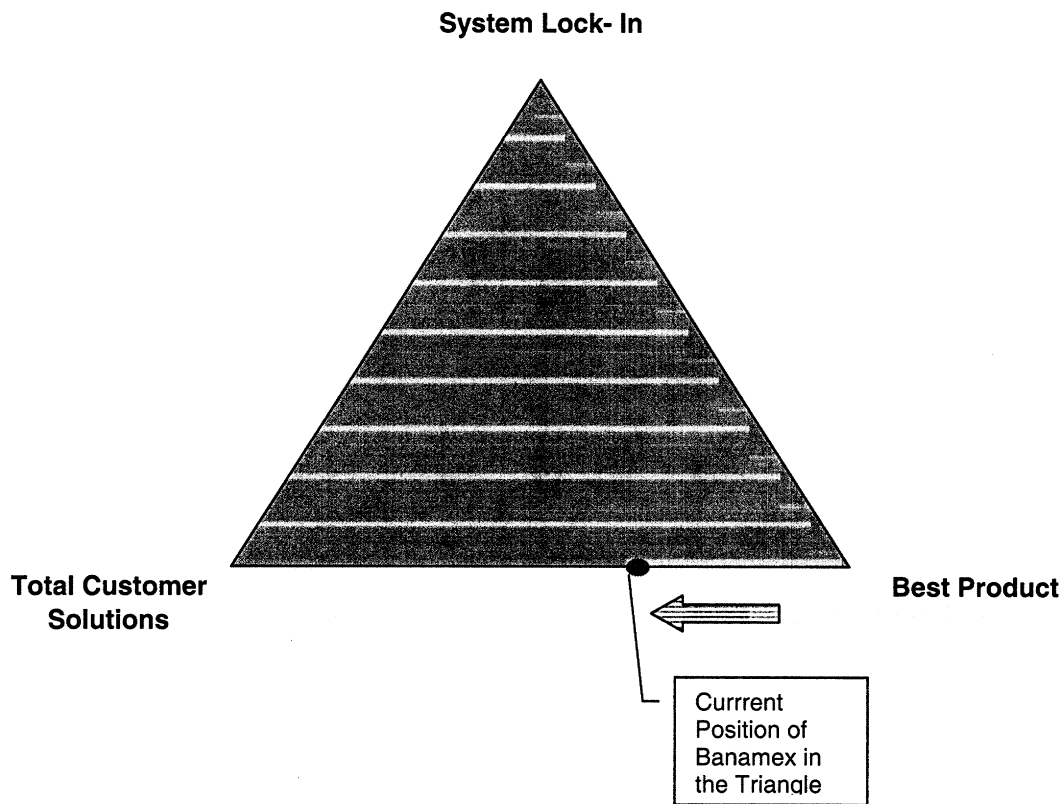


Figure 18. Current Position of Banamex in the Triangle

The organizational design of Banamex has been changed a number of times since the privatization of the bank, to try to find the right formula to promote a more integrated market approach for its customers. This process was affected for a while by the 1995 crisis, which made the management focus primarily on the survival of the bank. Now Banamex appears to be in a position to continue to implement the changes necessary to provide its customer a better business proposal and increase its customer “share of wallet”.

CHAPTER 7

Options to strengthen Banamex's Strategic Position

As previously mentioned in this thesis, increased competency is anticipated and the current leadership position of Banamex in the Mexican banking industry will be severely threatened, as the economic outlook continues improving.

The main threats will come from the foreign banks, both in the form of current foreign participants in Mexico, or in the form of new entrants with none or very little presence in the Mexican market.

Since Banamex follows the universal banking model, the threats to Banamex will come in most of the segments and businesses in which it participates. Banamex appears to be in good position to face the challenges from the changing environment and new entrants, however there are some specific segments in which in my opinion, it has been losing leadership and will continue to lose share in the future.

There are some country conditions that make Banamex's position strong. These conditions are mainly the following:

- economic issues, Mexico is still a country of volatile economic conditions, economic stability has not been totally achieved and the country will face an important test this year and the next year, because of the elections and the government change; this volatility could increase if the long- time ruling party (PRI) is defeated
- political issues, the long- time ruling party has not been able to maintain control of the House and therefore, banking regulations and supervision, although desired by all parties have sometimes become the subject of political debate rather than economic debate
- legal issues, Mexico has not had a strong enough legal system, leaving sometimes investors and banks uncertain of adequate law enforcement

These three factors are traduced in increased risk for the participants in the Mexican banking industry, and although this risk is the same for everyone, Banamex and the rest of the Mexican banks have always operated in this environment. Key for a successful conduction of business in this environment is

sound knowledge of the clients for a proper risk evaluation, and very solid business relations.

On the other hand, there are very important factors that will affect Banamex's strategic business units and lines of business in the near future. The main threats are described bellow:

- in Corporate Banking, increasingly the bigger Mexican corporations have expanded their businesses to other countries. Banamex, being a Mexican bank exclusively, cannot offer them full international payment and cash management system capabilities, so steadily it has been loosing share of this business. On the lending side, Banamex's funding abilities have been capped by the country's risk, and increasingly, the bigger Mexican corporations have been able to access the international banks and capital markets in search of lower cost of capital to compete internationally, creating disintermediation for the Mexican banks

- In Private Banking, the breadth and depth of investment products offered by Banamex have not been enough to retain and attract high net worth individuals, who are increasingly being attracted to foreign banks and brokerage houses that offer a wider and deeper array of investment products, specially in foreign currencies

- in commercial banking, due to the structure of Banamex's credit approval process, the lack of appropriate financial and market information from the client, the risk involved in these kind of credits, and increased regulations, the time to response to a credit petition to the mid- size and smaller companies has been slow. Speed in this market is key to success and penetration, since this kind of companies mostly work with one or two banks. New entrants such as G E Capital and other institutions that specialize in asset- backed lending are increasingly gaining market share in this segment

- in Trust banking, the larger corporations with multi- national assets and markets, are increasingly using foreign banks, better known to international investors, for certain transactions. Also at the individual level, certain estate planning products for high net worth individuals are increasingly being offered to them by foreign institutions

- in the branch service, the increased product scope now offered at the branch level, has caused some confusion in Banamex's employees who have to be subject to continuous training and also in some customers, who in the past were used to deal with specialists in each product from different institutions.

- in the account officer function, where in the past the job was mainly to promote credit and some services, now a lot of emphasis has been put in selling an increased product line- up, causing some confusion in Banamex's employees that have to be continuously trained

Review of Banamex's Options in the Triangle

As was discussed in the previous chapter, Banamex's current position in the Triangle is situated between the Best Product and Total Customer Solutions corner, slightly closer to the Best Product position but apparently moving towards the Total Customer Solutions position.

There is not an ideal position in the Triangle, rather there are correct ways to compete under a given position. The position in which Banamex is now is difficult, because it is still very much based in cost considerations and product differentiation.

A cost strategy has certain limits from which it cannot go any further, and product innovation and differentiation is only temporary. Bonding in this position is not achieved. On the other hand, cost is a very important factor in the client's decision process, and Banamex could very well achieve specific cost

advantages, specially in peso funding, and at the same continue leading in innovation as it has happened in the past in the Mexican market.

In my opinion there are two possible options in the context of the Delta Model that Banamex could pursue, Best Product and Total Customer Solutions. The System Lock- In alternative is almost impossible to obtain in the banking industry, since many of the products and services offered in the market are almost “commodity” products, and proprietary standards are very difficult to get. Also, as companies grow, they almost always need to have different banks and not to rely on only one “money supplier” and “money client”. The bigger the corporation, the more banks it needs, due to credit limits, cost considerations, and strategic reasons.

Option 1. Enhancing the Best Product Strategy

Although Banamex appears to be trying to move away from the Best Product strategy towards the Total Customer Solutions strategy, careful consideration should be put into evaluating the convenience of the Best Product option.

The Best Product strategy has as disadvantages its cost consideration and the reliance on product innovation in an industry where there is virtually no “patents”

for financial products. These disadvantages have been discussed in previous chapters, and the bonding process is almost non-existent.

On the other hand the Best Product Strategy brings also some important opportunities for Banamex that should be evaluated. Following is a description of these opportunities:

- Of all the remaining Mexican banks, Banamex is the most suitable to obtain advantages in this strategy. Due to Banamex's relative financial strength, it could have the depth necessary to sustain a price war in this moment in time. This is not necessarily true with regards to the foreign banks, however, in peso denominated operations, which are the majority of financial operations in Mexico, Banamex has developed unparalleled strengths that could be exploited to put a lot of pressure on competitors.

- Banamex has been working internally to reduce costs and be operationally self-sufficient (the traditional deposits and credit margin or financial margin, is enough to cover all sales and administrative expenses), and does not have to rely only on brokerage income and commissions to make money.

- Aside from being the most recognized and solid Mexican bank, Banamex has been active in the international financial markets for a long time, and has developed good dollar funding sources, and therefore could selectively offer better prices to its clients. This represents a big advantage versus Mexican competitors. Banamex is at a disadvantage versus foreign competitors. Nevertheless a strong balance sheet allows Banamex to take considerable amounts of risk in Mexican corporations that some foreign banks are not willing to take now, so with an aggressive pricing strategy, Banamex could compete successfully in the dollar credit markets.

- Banamex has had a long- time innovation tradition over the years. Banamex could focus on pushing its product development capabilities and technological infrastructure to capture the market through a permanent strategy of product innovation.

- Banamex has taken a series of actions to pursue the lowest operational costs in the industry and can count on experienced management to increase productivity

- Banamex has been able to leverage on its sales force to cross- sell and distribute financial products of its subsidiaries and sister companies, at a very low cost and with quick market penetration

In conclusion, Banamex has a series of strengths that could let it compete successfully at this time with a Best Product strategy. Banamex's financial strength, infrastructure advantages, product innovation offering, human resources depth and skilled management put it in a position to push further this strategy, however, these characteristics are not necessarily permanent or sustainable, since bigger banks are eventually going to enter the market and could very well have better capabilities and skills, and better financial strengths and resources.

Option 2. Heading towards the Total Customer Solutions Strategy

The Total Customer Solutions option for Banamex represents a move out of their traditional way of doing business into a more effective but more complex scheme. It represents the continuation of its present move towards a more integrative customer approach.

Total Customer Solutions represents a more complex strategy, where a thorough understanding of the customer needs is key to success. Also, much more flexibility is required in order to materialize the needs and wants of a certain

customer within a typically “rigid” organization with “rigid” systems and product scope.

The Total Customer Solutions strategy is much more complicated to execute than the Best Product strategy, but its rewards could be very significant and its sustainability greater. It requires a closer coordination between the different strategic business units and the sales force.

Following are the main opportunities for Banamex in pursuing the Total Customer Solutions strategy.

- Banamex has long- standing relationships with a big number of the Mexican corporations. This could be traduced in a better knowledge and understanding of customer needs
- Banamex has a national network of branches and ATM's, and large information systems that could be used to support the client's operations. Banamex could partner with some of its clients in order to help them better serve their markets by using the bank's infrastructure
- Banamex can tailor make special credit vendor programs with its customers to support the client's sales efforts and in the process help them increase their sales and bottom line. This requires a big degree of coordination between the bank and the customer, but the benefits could be very significant

- Banamex could exploit its banking relationships, specially in Latin America, to explore the possibility of partnering with foreign banks, to provide international cash management alternatives to its client base. The cost could be a little higher for the customer than the normal cost of contracting directly with a foreign bank, but would reduce complexity and overall transaction costs for the customer
- Banamex could include financial products or offerings of its competitors in its internet financial portal as a way of reducing transaction costs for its customers, provided that Banamex shares an important part of the resulting revenue from that service, that is collected by the incumbent financial institution
- Banamex, its subsidiaries and its sister companies, cover almost the full scope of financial services available in the Mexican market. By bundling all or a substantial portion of this products, it could provide the customer cost benefits, and reduced transaction and operational costs

In summary, the Total Customer Solutions strategy is a more complex approach to do business. Banamex has been pursuing the Best Product strategy for a long time, but has recently started changing direction towards Total Customer Solutions; this has brought important changes, both in the organizational structure and the culture of the organization. Traditionally, Banamex has been transaction- oriented and the concept of improving the client's economics is not totally familiar in the organization.

The concept of “solution- provider” required in the Total Customer Solutions strategy, implies improvement in the way solutions are proposed and structured, and in the way Banamex, its subsidiaries and sister companies work together. Coordination of all these entities is the key for the total solutions approach that would be the ultimate business strategy.

Although the Total Customer Solutions strategy has inherent difficulties to overcome, Banamex has the required elements and means to pursue it. The closer relationships and understanding with the clients, and the understanding of their needs can let Banamex provide a better and anticipated solution to the customers demands and permit the bank to capture higher economic benefits from this interaction.

I believe that Banamex should pursue this strategy and move even beyond the Total Customer Solutions point to at least try to lock- out its main competitors. By moving towards the Total Customer Solutions strategy, Banamex could significantly increase the switching costs of its customers and create a closer bonding with them. To this date, this approach would be almost unique in the Mexican banking industry and would enhance Banamex's image of quality and innovation.

CHAPTER 8

Conclusion

The Mexican banking system has experienced tremendous changes that significantly have affected the industry. Nationalization first and privatization later affected severely the status quo of the industry. Privatization brought a new breed of bank managers to the industry that were not sufficiently prepared to handle a booming industry.

The Mexican economic crisis of 1995 triggered unveiled major problems in the banking industry that led to the bankruptcy of a number of banks and made necessary big capitalization programs for other banks. The banking industry suffered greatly and only a handful of banks were able to survive. Banks that had to be taken over by the Mexican government are now been sold to mostly foreign banks eager to enter or take bigger positions in an under- banked market with a promising economic outlook. Some foreign banks envision Mexico as a platform to launch an expansion strategy throughout Latin America.

In the global arena, the banking Industry has also experienced major transformations in the past 20 years. Technology developments, such as electronic banking and Internet banking have also triggered a trend for the

globalization and consolidation of the banking industry. The advent of Internet banking has made many of the previously existent barriers- to- entry disappear, allowing for new competitors to enter the market. It has also changed the value proposition making it more transparent to the investor, increasing price competition.

New telecommunications possibilities, the banking industry deregulation and the low telecommunications costs prevailing, have made banking globalization possible, putting increased pressure in the institutions competing in this industry. Such pressure has been manifest in an increasingly fierce competition for customers, and narrowing intermediation spreads.

Consolidation has been another very important phenomenon affecting the banking industry in the past 10 years. Bank mergers and buy- outs have been occurring around the world, not only between a nation's borders, but also between banks in different parts of the world, increasing competition in the financial services sector that has generated a race to consolidate the industry and achieve a greater scale as a necessary prerequisite for improving efficiency.

Further mergers are anticipated to a point where the world will only have very few large global banks, a number of regional and super- regional banks, and a big and diverse array of community banks. In this environment, competition has

increased dramatically and consumers have access to a great deal of information in order to make the right pick as to who will be their financial services providers.

In this environment, an analysis of the strategic position of Banamex reveals many threats, but also many opportunities. The dominant position of Banamex in the Mexican banking industry will most likely be severely challenged in the medium term future. New foreign entrants to the Mexican industry will play a very important role in the shaping of the industry. The recently announced merger of Bancomer, the second largest Mexican bank and Banco Bilbao Vizcaya Argentaria, the second largest Spanish bank (and a bank with big and increasing international focus) is a proof of the changes to come. If that merger is approved and takes place as expected, Banamex will no longer be the largest participant in the industry.

On the other hand, the changes in the industry, specially mergers and new ownership will provide Banamex with an important but short- lived window of opportunity to increase its presence while the other participants regroup and prepare for competition.

After analyzing the current strategic position of Banamex, two alternatives for a strategic approach are being proposed. The first proposal involves an enhancement of the Best Product strategy that Banamex has traditionally

followed, leveraging on the banks financial strengths and product, technology and managerial infrastructure to further stress Banamex competitive advantages.

The second proposal is about moving Banamex's strategic position towards a Total Customer Solutions strategy, fundamentally including a better knowledge and understanding of customer's needs in order to leverage Banamex's capabilities and product scope to totally solve its client's financial requirements.

The move towards the Total Customer Solutions is assessed as the better of the two alternatives. The decision concerning the future strategy of Banamex corresponds to its management and stakeholders.

Appendix 1

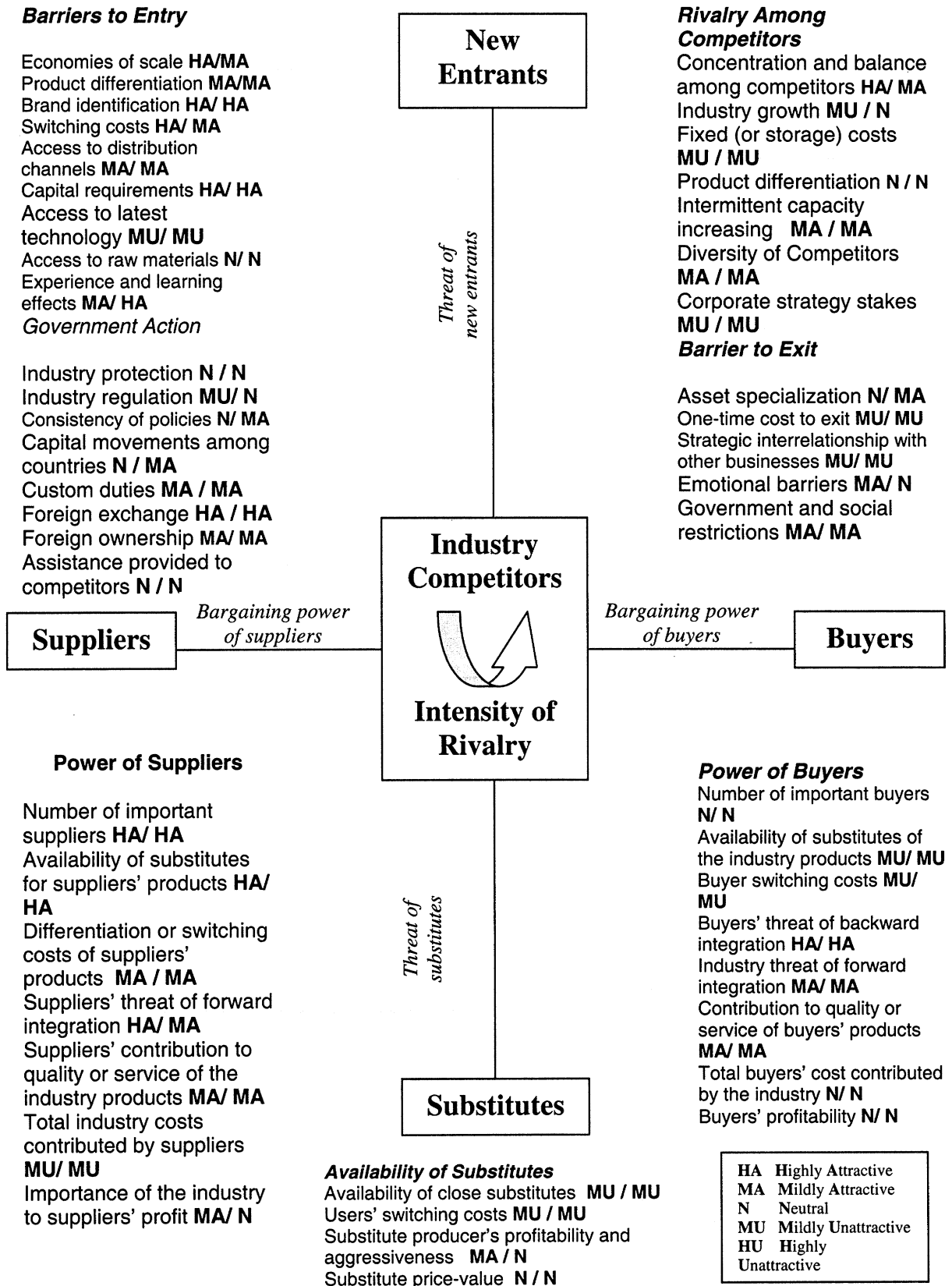
Table 5: Bank Consolidation Accelerated in Mexico Over the Last Five Years

Mexico Before (1994)				Mexico After (1999)			
	Market Share	Deposit	Square	Market Share	Deposit	Square	Deposit
	12/31/94	12/31/94	Market Share	6/30/99	6/30/99	Market Share	Market Share
1 Banamex	22.9%	522.7	522.7	22.5%	505.5	505.5	505.5
2 Bancomer	19.1%	364.0	364.0	20.8%	431.4	431.4	431.4
3 Banca Serfin	12.9%	166.0	166.0	13.6%	185.2	185.2	185.2
4 Comermex	7.0%	48.6	48.6	13.2%	174.1	174.1	174.1
5 Banco Mexicano	6.8%	46.1	46.1	6.9%	47.4	47.4	47.4
6 Bital	4.9%	23.8	23.8	6.7%	44.5	44.5	44.5
7 Banca Comifa	4.2%	17.8	17.8	5.3%	28.2	28.2	28.2
8 Banco del Atlántico	4.0%	15.9	15.9	5.3%	27.8	27.8	27.8
9 Banorte	3.1%	9.5	9.5	2.1%	4.4	4.4	4.4
10 Probusa	2.9%	8.4	8.4	0.9%	0.8	0.8	0.8
11 Bancrocer	2.8%	8.1	8.1	0.5%	0.3	0.3	0.3
12 Banca Promex	2.3%	5.3	5.3	0.3%	0.1	0.1	0.1
13 Banoro	1.8%	3.1	3.1	0.3%	0.1	0.1	0.1
14 Banco del Centro	1.6%	2.5	2.5	0.2%	0.0	0.0	0.0
15 Inbursa	0.8%	0.6	0.6	0.2%	0.0	0.0	0.0
16 Citibank Mexico	0.7%	0.5	0.5	0.2%	0.0	0.0	0.0
17 Banco Obervo	0.6%	0.3	0.3	0.2%	0.0	0.0	0.0
18 Intersecciones	0.3%	0.1	0.1	0.2%	0.0	0.0	0.0
19 Anahuac	0.3%	0.1	0.1	0.1%	0.0	0.0	0.0
20 Banco del Sur este	0.2%	0.0	0.0	0.1%	0.0	0.0	0.0
Subtotal		1243.4	1243.4	Subtotal	1449.8	1449.8	1449.8
		HH Index	1243.5		HH Index	1449.9	1449.9

- Cumulative market share:
 - 5 largest banks: 69%
 - 10 largest banks: 88%
 - 20 largest banks: 98%
 - Number of foreign banks within "top 10": 0
 - Names of foreign banks within "top 10": none
 - Cumulative market share of all foreign banks within "top 20": 1%
-
- Cumulative market share:
 - 5 largest banks: 77%
 - 10 largest banks: 97%
 - 20 largest banks: 100%
 - Number of foreign banks within "top 10": 3
 - Names of foreign banks within "top 10": BBVA, Citibank, BSCH
 - Cumulative market share of all foreign banks within "top 20": 16%

Source: Boletín Estadístico de Banca Múltiple, Comisión Nacional Bancaria y de Valores de México.
¹Includes Banca Promex.
²Includes Banco del Atlántico.
³Includes Banypais and Banco del Centro.

Appendix 2



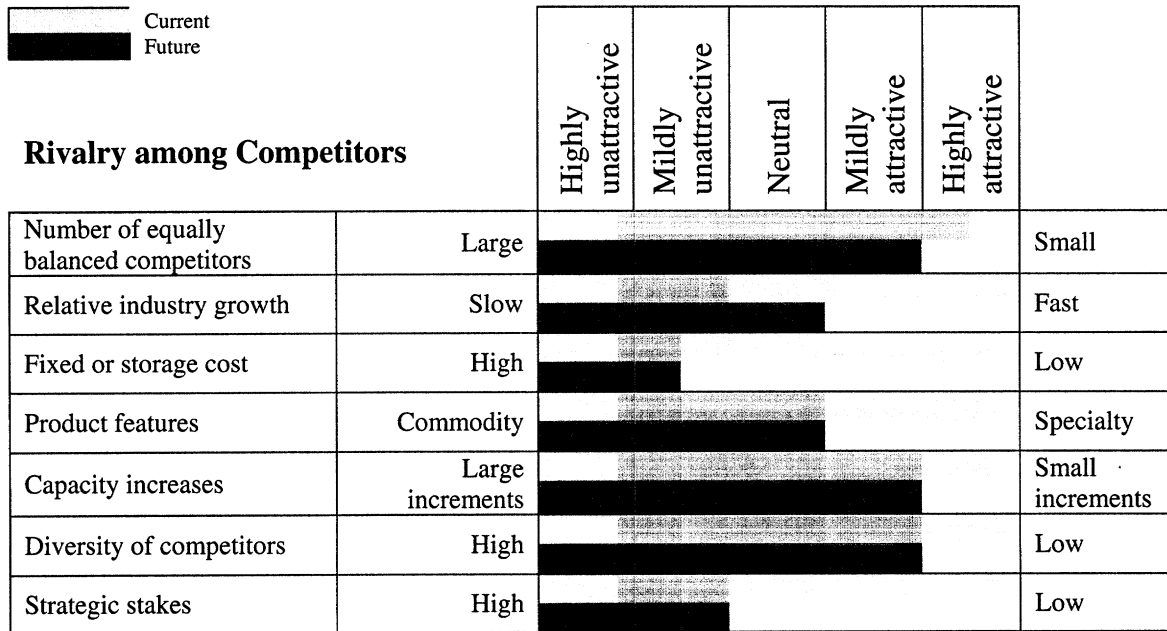
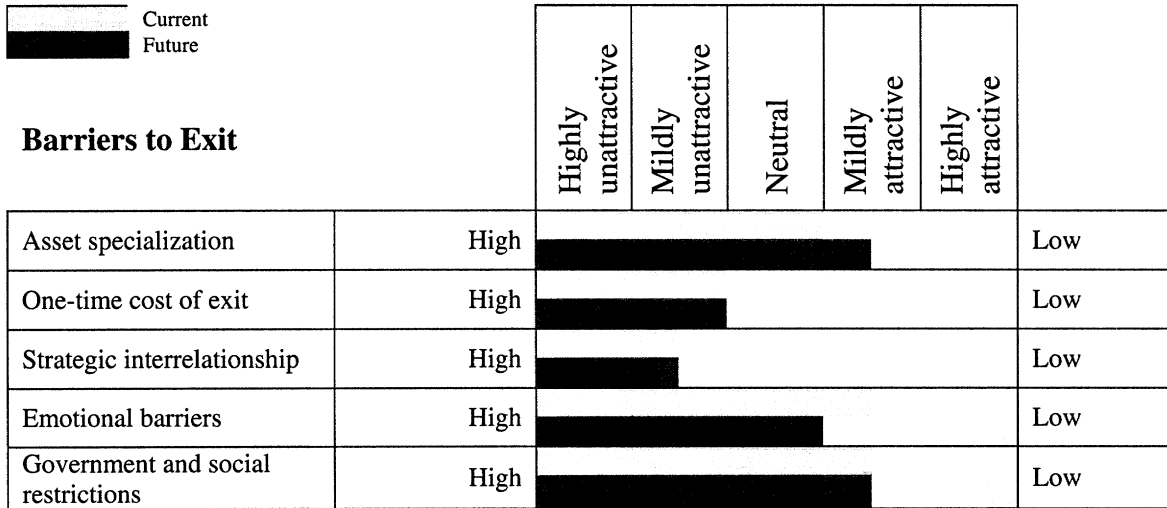
Appendix 3

Current
 Future

Barriers to Entry

		Highly unattractive	Mildly unattractive	Neutral	Mildly attractive	Highly attractive	
Economies of scale	Small						Large
Product differentiation	Little						Big
Brand identification	Low						High
Switching cost	Low						High
Access to distribution channels	Ample						Restricted
Capital requirements	Low						High
Access to latest technology	Ample						Restricted
Access to raw material	Ample						Restricted
Government protection	Negative impact						Positive impact
Experience effect	Unimportant						Very important

Appendix 3, Continued




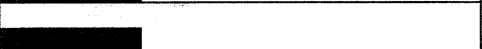


Appendix 3, Continued

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		Highly unattractive	Mildly unattractive	Neutral	Mildly attractive	Highly attractive		
Power of Buyers								
Number of important buyers	Few						Many	
Availability of substitutes for industry products	Many						Few	
Buyer switching costs	Low						High	
Buyers' threat of backward integration	High						Low	
Industry threat of forward integration	Low						High	
Contribution to quality or service of buyers' products	Small						Large	
Total buyers' cost contributed by the industry	Large fraction						Small fraction	
Buyers' profitability	Low						High	









		<div style="display: flex; justify-content: space-between; align-items: center;"> <div style="display: flex; flex-direction: column; align-items: center;"> <div style="width: 10px; height: 10px; background-color: #cccccc; margin-bottom: 2px;"></div> Current </div> <div style="display: flex; flex-direction: column; align-items: center;"> <div style="width: 10px; height: 10px; background-color: black; margin-bottom: 2px;"></div> Future </div> </div>						
		Highly unattractive	Mildly unattractive	Neutral	Mildly attractive	Highly attractive		
Power of Suppliers								
Number of important suppliers	Few						Many	
Availability of substitutes for the suppliers' products	Low						High	
Differentiation or switching cost of suppliers' products	High						Low	
Suppliers' threat of forward integration	High						Low	
Industry threat of backward integration	Low						High	
Suppliers' contribution to quality or service	Large						Small	
Total industry cost contributed by suppliers	Large fraction						Small fraction	
Importance of the industry to suppliers' profit	Small						Large	

Appendix 3, Continued

 Current
 Future

		Highly unattractive	Mildly unattractive	Neutral	Mildly attractive	Highly attractive	
Availability of Substitutes							
Availability of close substitutes	Large						Small
User's switching costs	Low						High
Substitute producer's profitability and aggressiveness	High						Low
Substitute price/value	High						Low

 Current
 Future

		Highly unattractive	Mildly unattractive	Neutral	Mildly attractive	Highly attractive	
Government Actions							
Industry protection	Unfavorable						Favorable
Industry regulation	Unfavorable						Favorable
Consistency of policies	Low						High
Capital movements among countries	Restricted						Unrestricted
Custom duties	Restricted						Unrestricted
Foreign exchange	Restricted						Unrestricted
Foreign ownership	Limited						Unlimited
Assistance provided to competitors	Substantial						None

Appendix 4. Banamex- THE VALUE CHAIN

